

<b>REPORT REFERENCE NO.</b>	DSFRA/22/7
<b>MEETING</b>	DEVON & SOMERSET FIRE & RESCUE AUTHORITY
<b>DATE OF MEETING</b>	18 FEBRUARY 2022 (Budget Meeting)
<b>SUBJECT OF REPORT</b>	APPOINTMENT OF EXTERNAL AUDITORS
<b>LEAD OFFICER</b>	Director of Finance, People & Estates (Treasurer)
<b>RECOMMENDATION</b>	<i>That the Authority opts-in to the sector-led Public Sector Audit Appointments (PSAA) arrangements for the appointment of external auditors for the financial years 2023-24 to 2027-28.</i>
<b>EXECUTIVE SUMMARY</b>	<p>The contract relating to the appointment of our current external auditors, Grant Thornton, covers up to and including completion of the 2022-23 audit. The auditors are currently working under a contract originally let by the Public Sector Audit Appointments (PSAA) following the closure of the Audit Commission. When the current transitional arrangements come to an end on 31 March 2023, the Authority will be able to move to the local appointment of the auditor. There are a number of routes by which this can be achieved, each with varying risks and opportunities.</p> <p>This report outlines three potential options available to the Authority one of which is to continue to opt-in to a sector-wide procurement conducted by PSAA.</p> <p>A decision on the appointment of an external auditor must be taken by the full Authority – it cannot be delegated. If the Authority wishes to opt-in to the PSAA invitation, it needs to confirm this with PSAA by 11 March 2022.</p>
<b>RESOURCE IMPLICATIONS</b>	As indicated in the report.
<b>EQUALITY IMPACT ASSESSMENT</b>	An initial assessment has not identified any equality issues emanating from this report.
<b>APPENDICES</b>	Nil.
<b>LIST OF BACKGROUND PAPERS</b>	<a href="#">The Local Audit and Accountability Act 2014</a> <a href="#">The Local Audit (Appointing Person) Regulations 2015</a>

## 1. INTRODUCTION

- 1.1. The requirements for the selection of external auditors for the financial statements of relevant authorities are set out in the Local Audit and Accountability Act 2014 (“the Act”) and the Local Audit (Appointing Person) Regulations 2015 (“the Regulations”) made under that Act. This Authority is a relevant authority for the purposes of the Act and the Regulations.
- 1.2. The relevant aspects of the Act for this Authority are:
- (a). that it must appoint an auditor to audit its accounts by no later than 31 December in the preceding financial year (Section 7);
  - (b). that the decision on how to appoint an external auditor **must** be exercised by the full Authority (Schedule 3 to the Act) i.e. it cannot be delegated either to a Committee or an officer; and
  - (c). that there are three options open to the Authority for appointing an external auditor:
    - (i). direct appointment **but** in doing so the Authority **must** take into account advice from its auditor panel on the selection and appointment of the external auditor;
    - (ii). direct appointment taking account of advice from an auditor panel established **jointly** with another relevant authority (Schedule 4 to the Act provides for the establishment of such a joint panel); or
    - (iii). opt-in to any “appointing person” arrangements in place (as per the provisions of Section 17 of the Act and the Regulations) for the appointment of the external auditor.
- 1.3. The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the National Audit Office), the format of the financial statements (specified by CIPFA/LASAAC) and the application of auditing standards currently regulated by the Financial Reporting Council (FRC). These factors:
- apply to all local audits irrespective of which option is used to appoint the external auditor;
  - are mandatory;
  - shape the work auditors undertake; and
  - have a bearing on the actual fees required.
- The Authority is, therefore, unable to influence the scope of the audit – irrespective of the method of selection of external auditor - and the regulatory regime inhibits the Authority’s ability to affect quality.
- 1.4. Appointments made in accordance with option (c)(iii) above are only valid, however, for the “compulsory appointing period” i.e. the financial years as specified in any invitation to the relevant authority to opt-in to the appointing person arrangements. Thereafter, a relevant authority must again determine the external auditor appointment on the basis of the options as set out above.

- 1.5. At its meeting on 19 December 2016, the Authority considered this matter and resolved to opt-in to the Public Sector Audit Appointments (PSAA) (the “appointing person”) arrangements for its financial statements for 2018-19 to 2022-23 (the “compulsory appointing period” as specified in the invitation to opt-in extended at that time by PSAA) i.e. option (c)(iii) above (Minute DSFRA/39 refers).
- 1.6. The Authority now needs to consider the arrangements for the external audit of its financial statements for the financial year 2023-24 onwards. PSAA has been confirmed by the Secretary of State in the role of “appointing person” for eligible principal bodies for the period commencing April 2023 and has written to this Authority inviting it to “opt in” to arrangements to appoint an external auditor for the five financial years 2023-24 to 2027-28. Should the Authority wish to opt-in, it is required to notify PSAA by 11 March 2022.
- 1.7. The remainder of this report explores the advantages and disadvantages to each of the options as identified in Paragraph 1.2(c)(i) to (iii) above along with other relevant considerations.

## **2. OPTION 1 - TO MAKE A STAND-ALONE APPOINTMENT**

- 2.1 To exercise this option, the Authority would have to establish an auditor panel in accordance with Section 9 of the Act. Section 8 of the Act requires the Authority to consult and take account of the advice of the auditor panel on the selection and appointment of an external auditor. In effect, therefore, the auditor panel would be responsible for the selection of the external auditor.
- 2.2 Schedule 4 of the Act stipulates that the auditor panel must be constituted either wholly or by a majority of “independent members” and must be chaired by an independent member. “Independent member” is defined in Schedule 4, which stipulates that an independent member **cannot**:
- be a member or officer of the authority (or any other relevant authority or entity with which the authority is connected at the time);
  - have been a member or officer of the authority (or any other relevant authority or entity with which the authority is connected) within the previous five years; and
  - be relative or close friend of a member or officer of the authority or any other relevant authority or entity with which the authority is connected at the time);
  - have any beneficial interest in a current contract with the Authority for the provision of goods and services;
  - be a current or prospective auditor for the authority; and
  - have been employed, within the previous five years, with either a current or prospective auditor.

- 2.3 The effect of these constraints on auditor panel membership is that any Authority Members appointed to the auditor panel would not have a majority input to assessing bids and choosing which firm of accountants to award a contract for the Authority's external audit.

***Advantages/benefits***

- 2.4 Setting up an auditor panel allows the Authority to take maximum advantage of the new local appointment regime and have some, albeit highly limited, local input to the decision.

***Disadvantages/risks***

- 2.5 There will be costs associated with the recruitment and servicing of the auditor panel, running the bidding exercise and negotiating the contract; in addition, on-going expenses and allowances will be incurred.
- 2.6 The Authority will not be able to take advantage of any reduced fees that may be available through joint or national procurement contracts.
- 2.7 The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by Authority Members.
- 2.8 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 but would require management of 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.

**3. OPTION 2 - SET UP A JOINT AUDITOR PANEL/LOCAL JOINT PROCUREMENT ARRANGEMENTS**

- 3.1. As previously referenced, Schedule 4 to the Act enables the Authority to establish a joint auditor panel with other relevant authorities. Again, though, such a Panel will need to be constituted either wholly or by a majority of independent members, with the same restrictions on being an independent member (as identified in paragraph 2.2 above) applying.
- 3.2. Additionally, if the Authority was minded to adopt this option:
- it would, in the first instance, need to assess the appetite of other relevant authorities to enter into such an arrangement; and
  - further legal advice may be required on the exact constitution of such a panel, having regard to the obligations of each authority under the Act.

***Advantages/benefits***

- 3.3. The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
- 3.4. There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.

### ***Disadvantages/risks***

- 3.5. The decision making body will be further removed from local input. There will be potentially no input from Authority Members where a wholly independent auditor panel is used or limited input in the event of this Authority appointing only one Member to the jointly constituted auditor panel.
- 3.6. The choice of auditor could be complicated where individual authorities have independence issues. An independence issue occurs where the auditor has recently or is currently carrying out work such as consultancy or advisory work either for the Authority. 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 choose a firm that is conflicted for this Authority, then a separate appointment, with all the attendant costs and loss of economies possible through joint procurement, may still be required.
- 3.7. As with Option 1, a local procurement exercise would seek tenders from the same nine eligible audit providers firms as the national procurement exercise but would require management of 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.
- 3.8. This, together with Option 1 above, would be more resource-intensive 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.
- 3.9. This option also requires a willing partner or partners of sufficient size to give the exercise a chance of being financially favourable. Early indications are that most of the potential partners for this Authority are, though, opting for 3 below.

## **4. OPTION 3 - OPT-IN TO "APPOINTING PERSON" ARRANGEMENTS**

- 4.1. PSAA is a not-for-profit organisation whose costs are around 4% of the scheme, with any surplus distributed back to scheme members. As previously referenced, PSAA has been confirmed by the Secretary of State in the role of "appointing person", in accordance with the Regulations, for eligible principal bodies for the period commencing April 2023. PSAA has written to this Authority inviting it to "opt in" to arrangements to appoint an external auditor for the five financial years 2023-24 to 2027-28.
- 4.2. 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.

4.3. 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 £3.5million to relevant bodies and in 2021 a further £5.6million was returned; and
- 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.

#### ***Advantages/benefits***

4.4. It is considered that there are a number of advantages and benefits to opting-in to the “Appointing Person” arrangements. These include:

- collective procurement reduces costs for the sector and for individual authorities compared to a multiplicity of smaller local procurements;

- it obviates the requirement for the Authority to establish its own auditor panel with an independent chair and either wholly, or a majority of, independent members to oversee a local auditor procurement and ongoing management of an audit contract;
- it represents 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 PSAAs 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.

### ***Disadvantages/risks***

- 4.5. Individual Authority Members will have less opportunity for direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.
- 4.6. For the sector-led body (i.e. PSAA) to be viable and to be placed in the strongest possible negotiating position, authorities are required to indicate their intention to opt-in before final contract prices are known.

## **5. OTHER CONSIDERATIONS**

- 5.1. 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, which attracted very competitive bids from audit firms. The resulting audit contracts took effect from 1 April 2018.
- 5.2. During 2018, however, 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 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.
- 5.3. The recommendations from these reviews are now under consideration by Government, with the clear implication that significant reforms will follow. A new audit regulator – the Audit, Reporting and Governance Authority (ARGA) - is to be established to replace the FRC and arrangements for system leadership in local audit are to be introduced. Further change will follow as other recommendations are implemented.

- 5.4. In particular, 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.
- 5.5. 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.
- 5.6. 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.
- 5.7. 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.

## **6. RISKS**

- 6.1. The main risk for the Authority associated with this issue are:
- it fails to appoint an auditor in accordance with the requirements and timings specified in the Regulations. In this event, Regulation 12 would require the Authority to notify the Secretary of State immediately. The Secretary of State may then direct the Authority to appoint the auditor named in the direction or may appoint an external auditor on behalf of the Authority i.e. there would be no choice in the matter for the Authority; and
  - the Authority fails to achieve value for money in the appointment process.
- 6.2. It is considered that both of these risks are best mitigated by opting-in to the sector led approach through PSAA.

## **7. FINANCIAL IMPLICATIONS**

- 7.1. Current external fee levels are likely to increase when the current contracts conclude at the end of the 2022-23 financial year.



- 7.2. The cost of establishing a local or joint Auditor Panel outlined in options 1 and 2 above would need to be estimated and included in the Authority's budget from 2022-23. This would include the cost of recruiting independent appointees (members), servicing the Panel, running a bidding and tender evaluation process, letting a contract and any agreed payments to Panel members.
- 7.3. Opting-in to the sector-led approach provides the 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. There will be no fee to join the sector led arrangements.
- 7.4. The audit fees that opted-in bodies will be charged by the sector led body will cover the costs of appointing auditors. The LGA believes that audit fees achieved through block contracts will be lower than the costs that individual authorities will be able to negotiate.

## **8. CONCLUSION**

- 8.1. The Authority has until 31 December 2022 to make an audit appointment, (Section 7 Local Government and Accountability Act 2014). In practical terms, this means that one of the options outlined in this report will need to be determined by the full Authority by spring 2022 so that the contract negotiation process can be carried out during the remainder of the year.
- 8.2. Authorities wishing to opt-in to the sector-led PSAA arrangements need to have notified PSAA of this by 11 March 2022.
- 8.3. For the reasons outlined previously in this report, Option 2 is considered the least feasible as there are unlikely to be many partners with which to establish a joint auditor panel. This would point to a choice between Option 1 and Option 3. On balance, it is considered that the benefits of Option 3 outweigh Option 1. Additionally, early indications are that, should the Authority determine Option 3 (i.e. the sector-led PSAA arrangements), it would be consistent with most other bodies in Devon and Somerset and most other Fire and Rescue Authorities.
- 8.4. In light of the above, the Authority is invited to approve option 3 and opt-in to the sector-led PSAA arrangements for the appointment of an external auditor for the financial years 2023-24 to 2027-28.

**SHAYNE SCOTT**

**Director of Finance, People & Estates (Treasurer)**