

Birmingham City Council

City Council

1 February 2022



Subject: **APPOINTEMENT OF EXTERNAL AUDITOR FROM 2023/24**

Report of: **Director of Council Management**

Report author: **Sara Pitt, Director of Finance**

Does the report contain confidential or exempt information? ☐ Yes ☒ No

If relevant, state which appendix is exempt, and provide exempt information paragraph number or reason if confidential :

1 Executive Summary

- 1.1 This report sets out proposals for appointing the external auditor to the Council for the accounts for the five-year period from 2023/24
- 1.2 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.
- 1.3 PSAA is now undertaking a procurement for the next appointing period, covering audits for 2023/24 to 2027/28. All local government bodies need to make important decisions about their external audit arrangements from 2023/24. Councils 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.
- 1.4 The report concludes that the sector-wide procurement conducted by PSAA will produce better outcomes for the Council than a procurement undertaken locally.

2 Motion

- 2.1 That the Council accepts 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.

3 Background

- 3.1 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 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).
- 3.2 In order to opt into the national scheme, a council must make a decision at a meeting of the Full Council.

The Appointed Auditor

- 3.3 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.
- 3.4 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.
- 3.5 The auditor must be registered to undertake local audits by the Financial Reporting Council (FRC) 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.
- 3.6 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.
- 3.7 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.

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

- 3.8 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.

- 3.9 During 2018 a series of financial crises and failures in the private sector led to questioning 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.
- 3.10 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.
- 3.11 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.
- 3.12 None of these problems is unique to local government audit. Similar challenges have occurred in other sectors, where increased fees and disappointing responses to tender invitations have been experienced during the past two years.
- 3.13 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

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

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.

- 3.14 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.

4 Options considered and Recommended Proposal

Appoint own external auditor

- 4.1 The Council may elect to appoint its own external auditor under the Act, which would require the council to;
- Establish an independent auditor panel to make a stand-alone appointment. 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. 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 Council's external audit.
 - Manage the contract for its duration, overseen by the Auditor Panel.
- 4.2 This option has the advantage of some Council involvement in the procurement. It does entail cost in terms of time and money to administer the procurement and there is no assurance a better tender response will be received as this option does not have the advantage of economies of scale.

Appoint jointly with other councils

- 4.3 The Act enables the Council 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 Council under the Act and the Council would need to liaise with other local authorities to assess the appetite for such an arrangement.
- 4.4 This option has the advantage of some Council involvement in the procurement although it is diluted with other partners. It does entail cost in terms of time and money to administer the procurement and there is no assurance a better tender

response will be received as this option does not have the advantage of economies of scale than the PSAA route

- 4.5 The Council has sought the views of West Midlands Councils as well as Core Cities councils. Nearly all are intending to opt-into the PSAA sector-led option, and this would not be a realistic option.

Join the national auditor appointment scheme

- 4.6 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.

- 4.7 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 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.

- 4.7 Although the Council will have no direct involvement in the procurement of an external auditor the PSAA will seek the Council's views on any preferences.

5 Risk Management

5.1 The principal risks are that the Council:

- fails to appoint an auditor in accordance with the requirements and timing specified in local audit legislation; or
- does not achieve value for money in the appointment process.

5.2 These risks are considered best mitigated by opting into the sector-led approach through PSAA.

6 Legal implications

6.1 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.

6.2 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 arrangement, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the Council under those arrangements.

6.3 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.

6.4 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. In July 2016 the Secretary of State specified PSAA as the appointing person.

7 Financial Implications

7.1 The duty to specify scales of fees is one of PSAA's statutory functions as the appointing person. Before setting a scale of fees, it is required to consult with opted-in authorities, relevant representative associations of local authorities and relevant bodies of accountants. The PSAA also consults other key stakeholders to ensure that the consultation is genuine and as productive as possible. Following consultation, the scale of fees is published on the website.

7.2 The scale fees for individual opted-in authorities are normally based on the scale fee for the previous year, in theory reflecting the auditor's assessment of audit risk and complexity. The PSAA would only expect variations from the scale fee to occur where these factors are significantly different from those identified and

reflected in the original fee. During the current tender period the audit fees have increased by some 50% for all Councils as a result of the increased audit requirements explained above.

7.3 There is a likelihood that current external audit fee levels could increase when the current contracts end. The reasons for this higher cost of audit include:

- **Limited auditor resource.** This has come about because many of the former Audit Commission staff have now exited the audit sector. The firms are now having to invest in their own internal training programmes for a very limited public sector audit market.
- **Higher audit standards.** This is due to audit shortcomings that have been identified following the collapse of high-profile companies, the audit testing regime has been enhanced to help ensure greater reliance on audit conclusions.
- **Introduction of new auditing and accounting standards,** requiring additional audit work in a variety of areas, such as accounting estimates and leases.
- **Introduction of the new Code of Practice,** covering a wider scope on Value for Money and reporting, increasing the volume of work required by experienced staff.
- **Increased risk profile and complexity of local authorities.** For example, entering new transactions, investments, and new models of delivery, increasing the time input of senior and experienced staff.

7.2 It is clear that the scope of audit has increased, requiring more audit work. There are also concerns about capacity and sustainability in the local audit market.

7.3 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.

7.4 If the national scheme is not used some additional resource may be needed to establish an auditor panel and conduct a local procurement. Until a procurement exercise is completed it is not possible to state what, if any, additional resource may be required for audit fees from 2023/24.

8 Appendices

8.1 None