



City of Westminster Audit and Performance Committee Report

Date:	1 December 2021
Classification:	General Release
Title:	Appointment of External Auditors for 2022/23 onwards
Wards Affected:	All
City for All Summary	External auditor requirements for the Council's annual statements of accounts
Financial Summary:	This report outlines the options and decisions required to appoint external auditors from 2022/23
Report of:	Jake Bacchus, Director of Corporate Finance

1. Executive Summary

1.1 The purpose of this report is to provide the Audit Committee with an update on the local authority external audit market and to outline the timeline and options available to the Council in appointing an External Auditor when the current arrangements reach their end.

2. Recommendations

- 2.1 To note that the Council will soon be required to make a decision in relation to the appointment of its External Auditors to commence from the financial year 2023/24.
- 2.2 To note the options available to the Council in relation to the appointment of its External Auditors from the financial year 2023/24.
- 2.3 To note the wider context in which the new appointment of External Auditors will be appointed within.

3. Background

Establishment of the PSAA

- 3.1 Public Sector Audit Appointments Limited (PSAA) is an independent company limited by guarantee incorporated by the Local Government Association in August 2014.
- 3.2 In July 2016, the Secretary of State specified PSAA 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.
- 3.3 Acting in accordance with this role PSAA is responsible for appointing auditors and setting scales of fees for relevant principal authorities that have chosen to opt into its national scheme, overseeing issues of auditor independence and monitoring compliance by the auditor with the contracts they enter into with the audit firms.
- 3.4 PSAA invited the Council to opt in, along with all other authorities, so that PSAA could enter into a number of contracts with appropriately qualified audit firms and appoint a suitable firm to be the Council's auditor.
- 3.5 The Council had three options, being 1) To undertake a complete procurement process itself and appoint its own auditor, or 2) Undertake a joint procurement with other bodies, or 3) To opt into a national collective scheme. The decision it made was to opt in to the national collective scheme.

Changes in the Audit Market

- 3.6 2018 proved to be a very significant turning point for the audit industry. A series of financial crises and failures in the private sector gave rise to questioning about the role of auditors and the focus and value of their work. In rapid succession we have then had the results of four independent reviews 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.
- 3.7 In total the four reviews set out more than 170 recommendations which are now in various stages of consideration by Government with the clear implication that a series of significant reforms will follow. Indeed, in some

cases where new legislation is not required, significant change is already underway. A particular case in point concerns the FRC, where the Kingman Review has inspired an urgent drive to deliver rapid, measurable improvements in audit quality. This has already created a major pressure for firms and an imperative to ensure full compliance with regulatory requirements and expectations in every audit they undertake.

- 3.8 By the time firms were conducting 2018/19 local audits, the measures which they were putting in place to respond to a more focused regulator, determined to achieve change, were clearly visible. In order to deliver the necessary improvements in audit quality firms were requiring their audit teams to undertake additional work to gain deeper levels of assurance.
- 3.9 However, additional work requires more time, posing a threat to firms' ability to complete all of their audits by the target date for publication of audited accounts (then 31 July) – a threat accentuated by growing recruitment and retention challenges, the complexity of local government financial statements and increasing levels of technical challenges as bodies explored innovative ways of developing new or enhanced income streams to help fund services for local people.
- 3.10 This risk to the delivery of timely audit opinions first emerged in April 2019 when one of PSAA's contracted firms flagged the possible delayed completion of approximately 20 audits. Less than four months later, all firms were reporting similar difficulties, resulting in more than 200 delayed audit opinions.
- 3.11 2019/20 audits have presented even greater challenges. With Covid-19 also impacting, unprecedented challenges faced the sector. Even with the benefit of an extended timetable targeting publication of audited accounts by 30 November, more than 260 opinions remained outstanding. It is vital that co-ordinated action is taken across the system by all involved in the accounts and audit process to address the current position and achieve sustainable improvement without compromising audit quality.
- 3.12 Delayed opinions are not the only consequence of the FRC's drive to improve audit quality. Additional audit work must be paid for. As a result, many more fee variation claims have been received than in prior years. Within Westminster, additional fees of £27,000 relating to changing audit requirements were proposed in Grant Thornton's 2020/21 Audit Plan, considered by this Committee in June 2021. Additional fees of £58,000 were incurred for 2019/20.
- 3.13 None of these problems are unique to local government audit. Similar challenges have played out throughout other sectors where increased fees and disappointing responses to tender invitations have been experienced during the past two years.
- 3.14 All of this points to an audit industry under enormous pressure and of a local audit system which is experiencing its share of the strain and

unavoidable instability as impacts cascade down to the frontline of individual audits.

- 3.15 While Westminster City Council has always met the audit completion deadlines, it is under increasing pressure to deliver in a timely manner due to the issues laid out above.

Audit Pricing

- 3.16 Audit fees must ultimately be met by individual audited bodies. The prices submitted by bidders through the procurement will be the key determinant of the value of audit fees paid by opted-in bodies. Regardless of the additional costs incurred by local authorities as fee variations, the PSAA national scheme has reduced the costs of local audits significantly. The core audit fee for the Council was £274,000 in 2014/15 whereas the scale fee quoted in the 2020/21 Audit Plan is £143,004 - £130,996 less.
- 3.17 Additional fees (fee variations) are part of the legal framework. They only occur if auditors are required to do substantially more work than anticipated, for example, if local circumstances or the Code of Audit Practice change or if the Regulator (the FRC) increases its requirement on auditors.
- 3.18 If the changes that relate to audit fees, proposed in MHCLG's recent consultation on the Appointing Person Regulations, are ultimately approved and implemented, PSAA will be able to manage the scale of fees and fee variations more flexibly. This will enable scale fees to be determined taking into account the outcome of more recently completed audits, and fee variations to be managed differently depending on whether they are driven by national or local factors.
- 3.19 Audit developments since 2018 have focused considerable attention on audit fees. The drive to improve audit quality has created significant fee pressures as auditors have needed to extend their work to ensure compliance with increased regulatory requirements. Changes in audit scope and technical standards, such as the requirement in the new Code of Audit Practice 2020 for the auditor to provide a VFM arrangements commentary, have also had an impact.

Summary of the options available

- 3.20 As a result of the position described in this report, the Council has three options:
1. To undertake a complete procurement process itself and appoint its own auditor, or
 2. Undertake a joint procurement with other bodies, or

3. To opt into a national collective scheme that PSAA is developing.
- 3.21 The option to undertake an individual procurement provides the Council with the independence to select a supplier itself. However this will require the time, effort and skill of having to undertake a procurement and appointment process. It will also involve specifying the service required, inviting tenders, evaluating tenders. In addition a single procurement will lack the buying power to significantly influence quality and price.
- 3.22 There would also be a need to establish an independent auditor panel. In order to make a stand-alone appointment the auditor panel would need to be set up by the Council itself. 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, this excludes 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 which audit firm to award a contract for the Council's external audit.
- 3.23 The option of a joint procurement with a small number of councils exists. Whilst previously this option was superseded by the national collective arrangement attracting better economies of scale, it would give the authorities a more direct relationship with the audit firm and allow some pooling of costs and expertise. At this stage it is unclear whether many of our local neighbouring boroughs are likely or not to opt in to the PSAA collective arrangement and would thus be inclined to join a smaller local joint procurement.
- 3.24 The option to take advantage of the national collective scheme is beneficial to the Council for a number of reasons. Although the Council loses some influence on the final outcome and will gain from:
- PSAA will ensure the appointment of a suitably qualified and registered auditor and expects to be able to manage the appointments to allow for appropriate groupings and clusters of audits where bodies work together;
 - PSAA will monitor contract delivery and ensure compliance with contractual requirements, audit quality and independence requirements;
 - Any auditor conflicts at individual authorities would be managed by PSAA who would have a number of contracted firms to call upon;
 - It is expected that the large scale contracts procured through PSAA will bring economies of scale and attract keener prices from the market than a smaller scale competition;
 - The overall procurement costs would be expected to be lower than an individual smaller scale local procurement;
 - The overhead costs for managing the contracts will be minimised through a smaller number of large contracts across the sector;
 - There will be no need for the Council to establish alternative appointment processes locally, including the need to set up and manage an 'auditor panel'; and

- A sustainable market for audit provision in the sector will be easier to ensure for the future.

1. Implications

Financial Implications:

- 1.1. The proposed fees cannot be fully known until the procurement process has been completed, as the costs will depend on proposals from the audit firms. Given the widespread prevalence of fee variations, market uncertainty and the revision to an 80% quality weighting within the procurement, it is almost certain that the fee payable by the Council will rise.
- 1.2. Opting-in to a national scheme provides a strong opportunity to ensure fees are as low as possible, whilst ensuring the quality of audit is maintained by entering in to a large scale collective procurement arrangement.
- 1.3. 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 for 2023/24.
- 1.4. The scope of the audit will still be specified nationally, the National Audit Office (NAO) is responsible for writing the Code of Audit Practice which all firms appointed to carry out the Council's audit must follow. Not all audit firms will be eligible to compete for the work, they will need to demonstrate that they have the required skills and experience and be registered with a Registered Supervising Body approved by the Financial Reporting Council or bid under the proposed arrangements whereby those going through registration or being 'supervised' by an appropriate approved body would be eligible.

Legal Implications:

- 1.5. 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. 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;
- 1.6. 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.

- 1.7. 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.

If you have any queries about this Report or wish to inspect any of the Background Papers, please contact:

Michelle Badham, mbadham@westminster.gov.uk

BACKGROUND PAPERS:

None