

**CORPORATE GOVERNANCE COMMITTEE – 5 NOVEMBER 2021****REPORT OF THE DIRECTOR OF CORPORATE RESOURCES****APPOINTMENT OF EXTERNAL AUDITOR****Purpose of Report**

1. This report summarises the arrangements for appointing the external auditor for Leicestershire County Council and the Leicestershire County Council Local Government Pension Scheme.
2. The Council has a statutory responsibility to appoint an External Auditor to audit its accounts. During the Autumn of 2021 all local government bodies will need to make a decision about their external audit arrangements for the period commencing from the financial year 2023/24

**Background**

3. The Local Audit and Accountability Act 2014 brought to a close the Audit Commission and the arrangements for the appointment of external auditors and the setting of audit fees for all local government and NHS bodies in England.
4. As part of the arrangements, the Secretary of State specified the Public Sector Audit Appointments (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. The PSAA is responsible for appointing auditors and setting scales of fees for relevant principal authorities that have chosen to opt into its national sector led scheme, overseeing issues of auditor independence and monitoring compliance by the auditor with the contracts entered into with the audit firms. This appointment comes to an end for the audit of accounts in 2022/23, with a new appointment being needed for the financial year 2023/24.
5. Following reports to the Corporate Governance Committee and the County Council in 2016, the County Council opted in to the PSAA auditor arrangements from 2018/19. Nationally, of 493 eligible local bodies, 484 opted into the PSAA scheme.
6. Grant Thornton UK LLP was appointed as the External Auditor for the County Council and its Pension Fund from 2018/19 until 2022/23.

7. In September 2021, the PSAA formally invited all principal local government bodies to opt into the sector led scheme for the second appointing period, which will provide external audit arrangements for the financial year commencing 2023/24. A copy of the prospectus can be found on their website at the link below:  
<https://www.psaa.co.uk/about-us/appointing-person-information/appointing-period-2023-24-2027-28/prospectus-2023-and-beyond/final-prospectus-2023-and-beyond/page/2/>
8. A decision to become an opted-in authority must be taken in accordance with the Regulations, that is by the members of an authority meeting as a whole, such as a meeting of the County Council.
9. An eligible body that has decided to join the national scheme must inform the PSAA by returning the Form of Acceptance Notice (issued with the opt-in invitation) no later than midnight on Friday 11 March 2022.

### **Options for the Local Appointment of External Auditors**

10. There are three broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act). These are as follows:

#### Option 1 - to make a stand-alone appointment

11. In order to make a stand-alone appointment the Council will need to set up an Auditor Panel consisting of a minimum of three members. The members of the Panel must be wholly or a majority of independent members as defined by the Act; this excludes current and former elected members (or officers) and their close family and friends. It will be the responsibility of this panel to assess and choose the firm of accountants that should act as the Council's External Auditors and local elected members will have limited involvement in that process.

#### *Advantages/benefit*

12. Setting up an Auditor Panel allows the Council to take maximum advantage of the local appointment regime and have local input to the decision.
13. Although limited, this option provides the ability for some elected member involvement in the process.

#### *Disadvantages/risks*

14. Recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract is estimated by the Local Government Association (LGA) to cost in the order of £15,000 plus on going expenses and allowances
15. The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.

Option 2 - Set up a Joint Auditor Panel / local joint procurement arrangement

16. 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 members. Further legal advice will 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.

*Advantages/benefits*

17. The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
18. 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*

19. The decision making body will be further removed from local input, with potentially no input from elected members where a wholly independent auditor panel is used or possibly only one elected member representing each Council, depending on the constitution agreed with the other bodies involved.
20. The choice of auditor could be complicated where individual Councils have independence issues (i.e. it has a conflict of interest). An independence issue occurs where the Auditor has recently or is currently carrying out work, such as consultancy or advisory work, for an Authority. Where this occurs, some auditors may be prevented from being appointed by the terms of their professional standards to carry out work for one or more of the Authorities in the group. There is a risk therefore that the Joint Auditor Panel may choose a firm that cannot carry out audit work for the County Council which would mean that the County Council would then need to make a separate appointment, giving rise to all the attendant costs and loss of economies possible through a joint procurement.

Option 3 - Opt-in to a sector led body

21. To join a Sector Led Body (SLB) specified by Central Government to act as the Appointing Person on behalf of opted-in authorities. The SLB would have the ability to negotiate contracts with the audit firms nationally, maximising the opportunities for the most economic and efficient approach to the procurement of external audit on behalf of the whole sector. The PSAA has been appointed as the SLB. As noted above, the Councils current External Audit provider was appointed under the PSAA procurement contract.

*Advantages/benefits*

22. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities. By offering large contract values, the firms would be able to offer better rates and lower fees than are likely to result from local negotiation. Any conflicts of interest with individual authorities would be managed by the SLB who would have a number of contracted firms to call upon. The appointment

process would not be ceded to locally appointed independent members. Instead a separate body is set up to act in the collective interests of the 'opt-in' authorities.

23. The audit costs are likely to be lower than if the Council/Authority sought to appoint locally, as national large-scale contracts are expected to drive more competitive prices from the audit firms.
24. Without the national appointment, the Council would need to establish a separate independent auditor panel, which could be difficult, costly and time-consuming.
25. The PSAA can ensure the appointed auditor meets and maintains the required quality standards and manage any potential conflicts of interest much more easily than the Council/Authority.
26. Supporting the SLB will help to ensure there is a vibrant public audit market for the benefit of the whole sector and this Council going forward into the medium and long term.

In respect of the PSAA itself:

27. It has considerable expertise and experience in the role of appointing auditors.
28. The Government has shown confidence in the PSAA by appointing it as the SLB for a second five-year period. The Department for Levelling Up, Housing and Communities (DLUHC) Spring statement refers to the PSAA's "strong technical expertise and the proactive work we have done to help to identify improvements".
29. It has a dedicated team that is very familiar at working within the context of the relevant regulations to appoint auditors, manage contracts with audit firms, and set and determine audit fees.
30. It is a not-for-profit organisation whose costs total around 4% of the national scheme with any surplus distributed back to scheme members, therefore offering value for public money. The PSAA is member of the DLUHC's new Local Audit Liaison Committee, and has regular contact with the DLUHC so is therefore able to give feedback on behalf of the sector.

#### *Disadvantages/risks*

31. Individual elected members will have no direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.
32. In order for the SLB to be viable and to be placed in the strongest possible negotiating position, it will need Councils to indicate their intention to opt-in before final contract prices are known.

#### **Financial Implications**

33. The table overleaf shows external audit fees for the last 5 years. The current PSAA contract started in 2018/19:

	County Council	Pension Fund
2020/21	£107,602	£34,530
2019/20	£81,767	£29,360
2018/19	£65,252	£21,280
2017/18	£76,950	£27,637
2016/17	£76,950	£27,637

34. The current PSAA contract did deliver savings on the previous appointments. However, as the Committee will be aware, there have been increases in the cost in recent years which are likely to continue no matter how the new contract is procured. 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.

### Summary

35. There are problems in the current audit market which have led to delays in the completion of many audits. The Redmond Review reported how local government audit is an unattractive market for audit firms and individual auditors to operate within. The market for this service is very limited and at present, only eight of the larger auditing firms have the accreditation, experience and specialist staff to undertake the work. These firms would be much more likely to bid for work through a larger procurement exercise rather than seek work from one or two isolated councils.
36. The Committee has received a number of reports at previous meetings with updates around the developments in local (external) audit arrangements and will be aware that the significant work to reform audit in the wake of the four government reviews (Kingman's review of the Financial Reporting Council; 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) is underway. Further wide-ranging changes are almost certain to occur during the next few years, and are very likely to have an impact on local authorities during the appointing period that will commence in April 2023. With this in mind, it is suggested that the PSAA with its standardised approach would offer the best route of support with stabilising the audit market.

37. It is recommended that Option 3 be pursued as this provides the maximum opportunity to limit the extent of any increases in costs by entering into a large scale collective procurement arrangement and would remove the costs of having to establish an Auditor Panel.

### **Next Steps**

38. The County Council has until March 2022 to formally opt in to the PSAA scheme.
39. The legislation requires that a decision to opt-in must be made by the County Council and, subject to the comments of this Committee, it is proposed that a report be taken to its next meeting on 1<sup>st</sup> December 2021 recommending Option 3 for approval.

### **Recommendation**

40. The Committee is asked to consider the options set out in this report and to recommend the County Council approve Option 3 i.e. to opt-in to the Sector Led Body national scheme (led by the PSAA) for local auditor appointments.

### **Equality and Human Rights Implications**

41. None.

### **Circulation Under the Local Issues Alert Procedure**

42. None.

### **Background Papers**

Corporate Governance Committee 23 September 2016 and 22 September 2017 – Appointment of External Auditor 2018/19 – update

<http://politics.leics.gov.uk/documents/s122619/Auditor%20Choice%20Sep16.pdf><http://politics.leics.gov.uk/ieListDocuments.aspx?CId=434&MID=4824>

County Council 7 December 2016 – Appointment of External Auditors 2018/19

<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=134&MID=4432>

Update on Developments in Local (External) Audit Arrangements/Audit and Governance Update/Developments in Audit and Governance – Corporate Governance Committee on 1 November 2019, 31 January and 25 November 2020 and 29 January and 4 June 2021:

<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=434&Mid=5782&Ver=4>

<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=434&MID=6053>

<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=434&MID=6492>

<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=434&Mid=6361&Ver=4><http://politics.leics.gov.uk/ieListDocuments.aspx?CId=434&MID=6493>

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