Subject:	**APPOINTMENT OF AUDITORS 2023/24 TO 2027/28**
Meeting and Date:	**COUNCIL – 26 JANUARY 2022**
Report of:	**Strategic Director (Corporate Resources)**
Portfolio Holder:	**Councillor Chris Vinson, Portfolio Holder for Finance, Governance, and Digital**
Classification:	**UNRESTRICTED**
Purpose of the report:	To opt into the national scheme for auditor appointment from April 2023.
Recommendation:	It is recommended that Council accept the invitation of Public Sector Audit Appointments (PSAA) to continue its current participation in the national scheme for auditor appointments.

1. **Summary**

1.1 The Council is required to publish accounts and to have those accounts audited in accordance with the Accounts and Audit Regulations 2015 To achieve this the Council must either itself, appoint external auditors, or opt into a scheme under which auditors are appointed for the Council by an "appointing person" under a national scheme in accordance with the provisions of The Local Audit (Appointing Person) Regulations 2015.

1.2 The recommendation is to continue with the current approach and remain within the national scheme for procurement and appointment of the auditors operated by Public Sector Appointments Limited (PSAA)[1], rather than to undertake independent procurement or procurement with a smaller group of local authorities in Kent.

2. **Introduction and Background**

2.1 Audit of local authority accounts is in a state of turmoil and the model is widely considered to be struggling, if not failing. At the time of writing Auditors have not completed the 2019/20 and 2020/21 audits on time for most councils and this is the case for Dover.

2.2 There are several factors that have led to this situation, the most significant of which are:

(a) disbandment of the Audit Commission;

(b) significant reduction in audit fees;

(c) market fragility;

(d) the work of the Financial Reporting Council;

(e) CIPFA; and

(f) the impact of Covid.

2.3 These are explained below.

[1] PSAA are a not-for-profit, independent company limited by guarantee incorporated by the Local Government Association in August 2014.

2.4 Disbandment of the Audit Commission (AC)

2.5 The AC was a public sector audit service. It managed a mixed economy for local authority audit, where some councils were audited by the main private sector audit partnerships and others by the commission itself.

2.6 The AC did not provide a perfect solution and had its critics. However, prior to its disbandment (by DHLUC's predecessor body, DHCLG), the AC was the main training body for public sector audit. Since disbandment the service has been provided entirely from the private sector. However, the sector has not maintained an adequate and continual supply and retention of trained public sector auditors. This has been a significant factor in the shortage of audit staff.

2.7 Significant Reduction in Audit Fees

2.8 Audit fees have been reduced through competitive tendering processes. In 2011/12 DDC paid the Audit Commission £159k for their last audit. For the 2020/21 audit grant Thornton's fees were £64k.

2.9 This reduction has put pressure on the total resources that the audit firms will commit to the audit while also seeking to make a profit for partners.

2.10 Market Fragility

2.11 In his recent review of local authority audit, Sir Tony Redmond highlighted how local audit is an unattractive market for audit firms and individual auditors to operate within. He indicated that "without prompt action… there is a significant risk that the firms currently holding local audit contracts will withdraw from the market".

2.12 This is a particular risk for local authority audit which is complex and highly specialised and compressed into a relatively narrow window. As a result, smaller audit firms are not generally well placed to take on this work and there are now very few firms in the market.

2.13 Work of the Financial Reporting Council (FRC)

2.14 Local authority accounts are required to be compliant with International Financial Reporting Standards and the FRC police the compliance with these standards through their monitoring of the auditors. However, IFRS were designed primarily for commercial organisations where investors, creditors, partners and other stakeholders have a genuine interest in the value of the company, its assets, liabilities, profits etc.

2.15 This model does not work for local authorities. The accounts of local authorities are overly long and complex for most stakeholders. They mimic commercial accounts, but then certain elements like depreciation and some pension costs are reversed out "below the line" ensuring they have no impact on the council taxpayer. This does not accord with the principles of IFRS.

2.16 Similarly, asset valuation, sales recognition etc are essential for commercial companies, have been at the heart of recent audit controversies and are important aspects of commercial audit. In contrast, the precise value of, for example, the total of all council houses owned by DDC, is of limited value when they are not to be sold en masse or to be the subject of a "hostile take-over".

2.17 Stakeholders in local authorities will generally want to know:

(a) where the funds came from,

(b) how they were spent and to what ends,

(c) what is left,

(d) does the council have sufficient to continue, and

(e) have any been misappropriated or used unwisely.

2.18 In contrast the FRC drives auditors to spend an undue proportion of their efforts on matters that do not address these points and the auditor's report that they now spend as much time responding to FRC enquiries and quality challenges as they do on the audit itself.

2.19 BEIS have consulted on replacing the FRC with a new body[2] – however it is unlikely to resolve this basic dilemma without changes to the accounts and the audit regime.

2.20 <u>CIPFA</u>

2.21 CIPFA (the Chartered Institute of Public Finance and Accountancy) is the specialist accounting body for the public sector and particularly local authorities. CIPFA produces the codes of practice which drive local authority accounts and the auditors check compliance.

2.22 The codes could be amended to be more suitable to the requirements of local authorities. This would improve the accounts and would ease the tension between the auditors and the FRC since the auditors would no longer be held accountable for enforcing codes that are not suitable.

2.23 To date, CIPFA have not amended the codes sufficiently to fully address this issue.

2.24 <u>The Impact of Covid</u>

2.25 Covid has depleted the resources of finance teams and added to their workload. It has had a similar impact on the auditors. Audits are now so delayed that their requests are starting to interfere with the budget cycle and past requests are being repeated.

3. **Issues and Changing Requirements for Local Authority Audit**

3.1 The requirements for local audit are likely to undergo significant change. The underlying reasons for this are set out in some detail in the (House of) Commons Library Research Briefing, 22 September 2021.

3.2 Key points and quotes from stakeholders / contributors to the briefing include:

(a) 98% of local authorities are opted in to the PSAA arrangements for appointment of auditors.

(b) These audits are undertaken by 5 firms, Ernst & Young, Mazars, Deloitte, BDO and Grant Thornton, with 70% carried out by just two firms.

(c) Redmond review: "…none of the six entities with responsibility for the different elements of the (audit) framework[3] has a statutory responsibility, either to act as a system leader or to make sure that the framework operates in a joined-up and coherent manner…As a result, the lack of coordination and the lack of a system leader is widely recognised as a weakness in the framework by most of the stakeholder groups." This weakness has led to the proposal to create the ARGA" (see footnote 2).

(d) "74% of the local authority respondents to the Call for Views think the format of the VfM opinion does not provide useful information. Some of these respondents recognised that the opinion is limited to giving assurance only that, processes are in place to secure value for money

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[2] The Government has stated that it supports making the new Audit, Governance and Reporting Authority (ARGA) the 'system leader' for local audit. The creation of ARGA, which is to replace the Financial Reporting Council, was proposed in a Government consultation which closed in March 2021. ARGA's creation will require primary legislation.

[3] This refers to the governance of audit, not the undertaking of the audits themselves.

and therefore that the opinion needs to be expanded to provide useful information."

(e) Grant Thornton: "The information currently reported publicly by auditors does not help local taxpayers understand the key issues. In particular, the annual letter, as currently constituted, … serves little purpose… a disproportionate amount of time on the audit is focused on the financial statements…"

(f) Tony Crawley, CEO PSAA: "…..some commentators think that the audit focus is not right for local government, as the (IFRS) standards focus on areas that do not match the sector's real risks, producing audits that are 'technically' driven but of less value to the bodies. The result is a tension between perceptions of audit quality and of audit scope."

(g) Professor Laurence Ferry, Durham Business School: "Public audit should, and should be seen to, serve the public interest. Public audit is not just another professional service. The current audit and inspection system is not broken in terms of what it does, but the question is whether it does the right thing. Currently, for local government, it is known what local authorities have spent (financial stewardship), but not what local government got for it (Value for Money (VfM – economy, efficiency and effectiveness), nor whether it has contributed towards fairness in society (equity)."

(h) Steven Sheen (formerly senior technical manager for PricewaterhouseCoopers): "Think how much more interesting the job would be if auditors were also concerned with confirming the adequacy of an authority's financial systems to support its operations (rather than just their sufficiency to support the financial statements), confirming financial standing, reviewing arrangements for preventing fraud and corruption and ensuring the legality of transactions, agreeing the effectiveness of governance arrangements and investigating matters brought to their attention by the public? Then think that this is probably what the public would want auditors to be doing (if it hadn't already presumed that this is what they do)."

4. Timescales

4.1 The key date is that auditors must be appointed for the 2023/24 accounts by December 2022. To achieve this the PSS require formal acceptance of the decision to opt in by 11 March 2022. The Council timetable means that this must be considered at the meeting of Council on 26th January 2022.

5. Identification of Options

5.1 The Council has three options:

(a) Procure its own auditors

(b) Procure auditors in partnership with some / all other Kent authorities.

(c) Accept the invitation by PSAA to opt-in to the national scheme.

6. Evaluation of Options

6.1 Procure Its Own Auditors

6.2 For the reasons set out above, the audit of local authority accounts is a specialised task that would not be available from small, local accountants / auditors. The technical skills and scale are only found in the 5 large audit firms who currently provide the service across England.

6.3 These firms currently work on contracts which are let by the PSAA on a regional basis, so that they each have economies of scale to take on a series of geographically contiguous audits, deploying teams that move from one authority to another, working out of a regional office.

6.4 Working up a procurement specification and process would be unduly burdensome, while the offer to work as an outlier and undertake a stand-alone audit of DDC accounts is unlikely to be attractive to the market, or to deliver an economic result for DDC.

6.5 For these reasons this option is not recommended.

6.6 <u>Procure auditors in partnership with some / all other Kent authorities</u>

6.7 Joint procurement with other Kent authorities does provide the potential to create a contract which may just be of sufficient scale to interest one or two of the five firms in the current market – although it should be noted that there are concerns that some firms may not seek future contracts, and this would further work against a Kent contract being of sufficient scale.

6.8 This would also require DDC to be confident that all / most districts and KCC wanted to join such a tender and that DDC could be confident, by March 2022, that the process would proceed successfully so that DDC does not need to opt-in to the PSAA arrangement.

6.9 At present there is no drive from the majority of Kent authorities to take this path and no apparent leader seeking to take on the main procurement role. For these reasons this option is not recommended.

6.10 <u>Accept the invitation by PSAA to opt-in to the national scheme</u>

6.11 The format and contents of local authority accounts is flawed, and their audit has significant issues which are likely to drive change. Nonetheless, the risks of DDC attempting to procure audit alone, or in a small Kent based group, are significant in terms of the resources required, the attractiveness of the offer to the market and the consequences of failure which would leave the council unable to discharge the statutory requirement for audit of the accounts.

6.12 In contrast, although procurement within the PSAA is not without issues, it is guaranteed to be undertaken based on the accepted sector requirements, to the appropriate / prevailing standards, on a scale that will attract the small group of firms that remain in the market, at minimal demand on DDC resources and capacity. In addition, should there be issues with the PSAA process, DDC will be in the same position as the 97% of other authorities, rather than isolated as it would be in options 1 & 2 above. This is also the arrangement that DDC participates in at present.

6.13 For these reasons this is the recommended option.

7. Resource Implications

7.1 The current fee for the 2021/22 audit is £64k. It is expected that the increasing demands on audit and the tightening of the market will lead to a fee increase but it is not possible to forecast by how much.

8. Climate Change and Environmental Implications

8.1 There are no climate change and environmental implications.

9. **Corporate Implications**

9.1 Comment from the Director of Finance (linked to the MTFP): The Director of Finance has been involved in the production of this report and has nothing further to add.

9.2 Comment from the Solicitor to the Council: The Solicitor to the Council has been consulted in the preparation of this report and has no further comments to make.

9.3 Comment from the Equalities Officer: This report does not specifically highlight any equality implications, however in discharging their duties members are required to comply with the public sector equality duty as set out in Section 149 of the Equality Act 2010 http://www.legislation.gov.uk/ukpga/2010/15/section/149.

10. **Appendices**

Appendix 1 – PSAA Invitation to Opt-in.

11. **Background Papers**

None.

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