

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Audit Committee
Date:	16 December 2021
Title:	Options for the appointment of external auditors
Report From:	Director of Corporate Operations

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Purpose of this Report

1. The purpose of this report is to outline the options available to the County Council for the appointment of external auditors for the 5 year period from April 2023 to enable the Audit Committee to make recommendations to Full Council.

Recommendation(s)

It is recommended that the Audit Committee:

2. Recommends to Full Council that the County Council accepts the invitation to opt-in to Public Sector Audit Appointments (PSAA) national scheme for the appointment of external auditors for Hampshire County Council (including the Hampshire Pension Fund) for the 5 year period from April 2023, noting that the decision to opt-in will be taken before contract prices are known.

Executive Summary

3. The Local Audit and Accountability Act 2014 requires local authorities to appoint an external independent auditor. This must be done no later than 31 December in the financial year prior to the year to be audited. The appointment may last for more than one year, but a new appointment must be made at least once every five years.
4. The accounts of the County Council and the Hampshire Pension Fund are currently audited by EY. This appointment was made through Public Sector Audit Appointments Limited (PSAA), an 'appointing person' specified by the Secretary of State. The County Council agreed to opt-in to this arrangement

in November 2016 rather than conducting its own procurement and appointment exercise.

5. The current contract will conclude with the audit of the 2022/23 accounts, however due to timescales set by PSAA, the governance requirements under the Local Audit and Accountability Act 2014, and procurement lead-in times, the County Council must decide by 11 March 2022 whether to again opt-in to PSAA's arrangements for the 5-year period commencing April 2023. A decision to opt-in will effectively be the appointment decision and in accordance with the Local Audit and Accountability Act, that decision must be made by Full Council.
6. To appoint an auditor outside of the PSAA scheme, the County Council would need to set up an auditor panel comprising a majority of independent members and run a procurement exercise. This could be individually or in collaboration with other local authorities.
7. Opting-in to the PSAA scheme has the potential to reduce costs to the County Council. The up-front procurement costs would be shared with other authorities opting-in to the arrangements and the larger contract value should allow audit firms to offer lower fees than they would to individual authorities. In addition, there would be no need to set up and service a local auditor panel and the contract would be administered by the PSAA, with local agreement regarding timescales and approach for each audit assignment. The disadvantages are that councils that opt-in will do so before knowing contract prices and will have no direct involvement in choosing auditors, as they will be appointed by PSAA. Fees throughout the life of the contract will be agreed by the PSAA, although local authorities can provide comments.
8. Conducting an individual or joint auditor procurement and appointment exercise outside of the PSAA's scheme would allow the County Council to have local input into the appointment of its auditor (although the auditor panel would have to comprise a majority of independent members). The County Council would incur the costs of recruiting and servicing the auditor panel as well as the costs of running a procurement exercise and managing contractual arrangements. The lower contract value may also lead to increased audit fees. In addition, the County Council's finance team produce the accounts for the partner organisations Hampshire and Isle of Wight Fire and Rescue Authority, Hampshire Constabulary and the Police and Crime Commissioner for Hampshire and currently benefit from economies of scale where all partners are audited by the same firm. There is a risk that this benefit could be lost if different auditors are appointed by any of the partners.
9. Working jointly with other authorities through a joint exercise could mean costs are reduced as they would be shared across the participating authorities. This approach would however also bring additional complexity and result in decision making being further removed from local input.

10. The current scale fees for the audit of the County Council and Pension Fund accounts are £89,720 and £24,442 per annum respectively. The auditors are then able to submit fee variation proposals to PSAA, who will review these proposals and may agree additional fees. The most recently agreed additional fees for 2019/20 were £27,104 and £13,593 for the County Council and Pension Fund respectively. Given challenges in the audit market there is an expectation that under all available options the contract price per annum could be greater than currently paid.

Existing external audit arrangements

11. The Local Audit and Accountability Act 2014 (the Act) abolished the Audit Commission and led to the establishment of transitional arrangements for the appointment of external auditors. These transitional arrangements were put in place to cover the period up to and including the audit of the accounts for 2017/18 and resulted in Ernst & Young LLP being appointed as the County Council's external auditors for this period. This appointment was made under a contract let by the Audit Commission and then managed by Public Sector Audit Appointments Limited (PSAA).
12. Reports were presented to the Audit Committee during 2015 and 2016 providing details of the requirements under the Act and outlining options available to the County Council at the end of the transitional period. The Audit Committee recommended to Full Council that the appointment be undertaken through engagement with PSAA as part of a sector-led appointment. This approach was agreed by Full Council in November 2016. Ernst & Young LLP (EY) were then appointed by PSAA for the period beginning with the audit of the 2018/19 accounts and concluding with the audit of the accounts for 2022/23. 484 of 493 eligible bodies (98%) [opted to join](#) the PSAA scheme for this period.
13. Although the existing arrangements will be used for the audit of the County Council's accounts for the 2021/22 and 2022/23 financial years, the governance requirements under the Act, opt-in deadlines set by PSAA, and the lead in times associated with the procurement and appointment of auditors means that it is now time to review options for the period beginning in April 2023 and for the Audit Committee to recommend an approach to Full Council.
14. This also applies to the audit of the Hampshire Pension Fund's accounts because the County Council is the Administering Authority and reporting entity for the Pension Fund. The Pension Fund is not a separate legal entity and pension funds are not listed as 'relevant authorities' in their own right within the Act, so there is no statutory basis for a separate auditor appointment within the Act. The auditor appointed for the County Council's accounts therefore also audits the Pension Fund. The audit of the Pension

Fund is however recognised as a separate engagement by the auditors with additional audit work, reporting and fees charged to the Pension Fund.

15. It is also worth noting that the County Council's finance team prepares accounts for the partner organisations Hampshire and Isle of Wight Fire and Rescue Authority, Hampshire Constabulary and the Police and Crime Commissioner for Hampshire, all of whom form part of the shared services partnership. All partners opted-in to the PSAA arrangements for 2018/19 to 2022/23 and are currently audited by the same audit firm (EY) and use the same financial systems. This has enabled the County Council to benefit from economies of scale in the external audit process. All partners have the same deadline to decide whether to opt-in to the PSAA scheme for the period from April 2023.
16. The current scale fees for the audit of the County Council and Pension Fund accounts are £89,720 and £24,442 per annum respectively. The auditors are then able to submit fee variation proposals to PSAA, who will review these proposals and may agree additional fees. The most recently agreed additional fees for 2019/20 were £27,104 and £13,593 for the County Council and Pension Fund respectively. The fee variation for the County Council's accounts included additional costs relating to pension valuation, PPE valuation and use of expert, PFI, Covid-19 impacts, and increased FRC challenge.
17. PSAA's own costs of managing the scheme are covered by audit fees paid by opted-in bodies.

Requirements under the Local Audit and Accountability Act 2014

18. The Local Audit and Accountability Act 2014 sets out that the accounts of a relevant authority must be audited in accordance with the Act by an auditor appointed in accordance with the Act. This appointment of an auditor must take place no later than 31 December in the year preceding the audit. An auditor may be appointed for more than one financial year, but a further appointment process must take place at least every 5 years. This does not prevent an authority from re-appointing an auditor at the end of a 5 year period.
19. There are three ways for a local authority to appoint an auditor under the Act:
 - Undertake an individual auditor procurement and appointment exercise
 - Undertake a joint auditor procurement and appointment exercise with other bodies
 - Opt-in to arrangements made through an 'appointing person' specified by the Secretary of State.

20. It is also worth noting, given recent challenges in the local audit market and the upcoming deadlines for appointing auditors for the 2023/24 accounts, that two consultations were conducted earlier in 2021 on local authority audit arrangements:
- MHCLG [consulted](#) on proposals to implement the recommendations from the independent [Redmond Review](#) of local authority financial reporting and external audit and are currently analysing feedback.
 - PSAA [consulted](#) on proposals for arrangements for auditor appointments from April 2023 under the national opt-in scheme.
21. The County Council submitted responses to both consultations.
22. In its response to the PSAA consultation, the County Council stressed the importance of appointing a competent auditor at a reasonable price, questioning whether evaluating tenders on the basis of 80% quality and 20% price gave sufficient weighting to the price of the audit, given that all audits should be completed to the required legal and auditing standards by default. The efficiency gains to the County Council and its partners of appointing the same audit firm for all accounts produced by the County Council's finance team was also highlighted. In addition, the response noted the need to address issues with the timeliness of audit opinions being issued across the sector.
23. In responding to the MHCLG consultation, the County Council suggested a review of the external audit approach to assessing financial resilience, which currently seems more aligned to private sector cash flows and the going concern concept. This is less relevant to local authorities given the statutory nature of the authorities.

Analysis of options for the appointment of auditors from April 2023

24. Details of the three options available to the County Council are set out below. The potential advantages and disadvantages of each option are then detailed in Table 1.
25. Under all three options, the County Council can only appoint firms registered to conduct local audits. Given challenges within the audit market there is an expectation that under all three options the contract price per annum could be greater than currently paid.

Option 1 – Individual auditor procurement and appointment exercise

26. The auditor appointment arrangements under the Act allow local authorities to appoint their own auditors via an auditor panel, with a requirement to consult

with the panel and take its advice into consideration in the selection and appointment of the auditor. The panel is also required to advise the authority on maintaining an independent relationship with its auditor.

27. An auditor panel must be made up of at least 3 members and a majority must be independent members, including the chair. The definition of independence is set out in the Local Auditor (Auditor Panel Independence) Regulations 2014 and includes a requirement that independent panel members have not been a member or officer of the authority within the last 5 years. Further criteria are detailed in Appendix 1
28. To enable the auditor panel to operate, the authority is required to provide information of relevance to the panel's work when requested and in addition members and officers are required to attend meetings of the panel to answer questions when asked. The Act also requires the authority to publish advice from its auditor panel, including details of whether or not advice has been followed and why.
29. The independent make-up of the auditor panel means that elected members will not have a majority input into assessing bids and choosing which firm is awarded the contract to audit the accounts of the County Council and Pension Fund.
30. The regulations also allow the use of another authority's auditor panel, which removes the need to constitute a new auditor panel and may increase independence. This however requires finding another authority with an established auditor panel willing to enter into this arrangement. It may also make it more difficult to ensure the specific needs of the authority are understood by the panel and the logistics for members and officers to interact with the panel may be more challenging (although the use of technology may mitigate this to an extent).
31. To run a procurement exercise, a tender process would need to be run in line with Public Contract regulations to produce a specification and evaluate bids, with the associated resource costs involving specialist officer input from Finance, Legal and Procurement teams. Relevant resource and expertise would also be required for contract management. A compliant tender would ensure value for money but in a specialist market with limited numbers of approved suppliers it is likely that better value could be achieved by leveraging the scale of the PSAA offer to suppliers (see Option 3).

Option 2 – Joint auditor procurement and appointing exercise with other bodies

32. The Act also allows a local authority to establish a joint auditor panel with other local authorities for the procurement and appointment of auditors. The

requirements around the appointment of an auditor panel are the same as for Option 1, including the independence requirements.

33. The operational arrangements with this option will be more complex due to the need to set up and run an auditor panel jointly with multiple local authorities and the need to set up any associated contractual arrangements. There is also a need to find other authorities with the appetite to join such an arrangement.
34. There will also be procurement considerations to make, for example the decision as to whether to use a single tender process to procure a single contract for all bodies or whether instead to use a joint auditor panel but procure separately.
35. Similar considerations would be required as for Option 1 in terms of resources to support a procurement exercise and subsequent contract management, although these costs would be shared with other local authorities. The contract would likely be of lower value to suppliers than the PSAA offer.

Option 3 – Opt-in to national scheme for auditor appointments through PSAA

36. The Secretary of State has confirmed PSAA in the role of the appointing person for eligible principal bodies for the period commencing April 2023. The County Council therefore has the option to once again opt-in to this national scheme for auditor appointments.
37. PSAA issued its invitation to opt-in to this scheme in September 2021 alongside its scheme prospectus and procurement strategy. To opt-in the County Council must send its formal acceptance to PSAA by 11 March 2022.
38. PSAA's procurement strategy sets out that its primary aim is to secure the delivery of an audit service of the required quality for every opted-in body at a realistic market price and to support the drive towards a long term competitive and more sustainable market for local public audit services. PSAA's costs of managing the scheme are covered by audit fees paid by opted-in bodies. PSAA is a not-for-profit organisation so returns any surplus funds to opted-in bodies.
39. PSAA plans to enter into contracts with a number of audit firms to provide capacity across all opted-in bodies and to enable the management of auditor independence issues (e.g. where an audit firm already provides consultancy and advisory services to a local authority it should not also audit the authority's accounts). There is also an aim to grow the number of active suppliers in the market. The expectation is that contracts will be awarded by

August 2022 and the PSAA [scheme prospectus](#) is available through its website.

Timescales

40. To exercise the option to opt-in to the national auditor appointment arrangements (Option 3) the County Council will need to inform PSAA by 11 March 2022. This is because of the lead-in time required to run a national procurement exercise. A decision to opt-in must be taken by Full Council, with the final meeting of County Council prior to the PSAA's opt-in deadline taking place on 17 February 2022.
41. If the County Council decides instead to appoint an auditor through either Option 1 or Option 2 (individual or joint procurement and appointment) then an auditor panel will need to be established and a procurement exercise will need to be run. Option 2 will also require the identification of other local authorities to create the joint auditor panel and agreement on any contractual and operational requirements. Any procurement exercise would need to be completed to allow the appointment of auditors no later than 31 December 2022. A fully compliant tender process would take a minimum of 6 months and be dependent on the availability and expertise of officers across Finance, Legal and Procurement and would need to factor in the requirements relating to the auditor panel.
42. The partner organisations Hampshire and Isle of Wight Fire and Rescue Authority, Hampshire Constabulary and the Police and Crime Commissioner for Hampshire will also be making decisions through their own governance arrangements about whether or not to opt-in to the PSAA scheme by 11 March 2022.

Table 1 – Advantages and disadvantages of the options available to the County Council

	Option 1 – Individual auditor procurement and appointment exercise	Option 2 – Joint auditor procurement and appointing exercise with other bodies	Option 3 – Opt-in to national scheme for auditor appointments through PSAA
Advantages	<ul style="list-style-type: none"> • Setting up an auditor panel allows the County Council to have local input into the appointment of its auditor (although the auditor panel must have a majority of independent members) • Able to set own procurement evaluation criteria rather than this being decided by PSAA (although must take advice from auditor panel) • Able to form a direct contract with the audit provider with the opportunity to agree contractual terms regarding performance and quality 	<ul style="list-style-type: none"> • Costs associated with setting up the auditor panel and running a procurement exercise can be shared across the local authorities involved with the joint process • May increase the chance to negotiate lower fees due to the larger combined contract value than for an individual procurement • Able to form a direct contract with the audit provider with the opportunity to agree contractual terms regarding performance and quality 	<ul style="list-style-type: none"> • Costs are shared across all authorities opting in to the arrangements • The larger contract value should allow audit firms to offer lower fees • Any conflicts at individual authorities would be managed by PSAA who would have a number of contracted firms to call upon • There is no need to set up a local auditor panel • The contract is managed by PSAA
Disadvantages	<ul style="list-style-type: none"> • Costs of recruitment and servicing of the auditor panel including expenses and allowances • Procurement costs to run a selection process and negotiate contracts • Lower contract value than other options reducing opportunities to negotiate lower fees, may result in higher audit fees • May result in the appointment of a different auditor from other partners¹ leading to loss of economies of scale within the finance team • The risk that the procurement process does not result in an appointable audit firm • Can only appoint firms registered for local audit so will not identify any additional suppliers to those available to the PSAA 	<ul style="list-style-type: none"> • Costs of recruitment and servicing of the auditor panel including expenses and allowances • Procurement costs to run a selection process and negotiate contracts • Decision making is further removed from local input. There may be a wholly independent auditor panel or there may be elected member representatives from each authority within an auditor panel that has a majority of independent members. • May lead to reduced control over the audit process if a joint contract is entered into • Potential for complications due to independence issues e.g. where an audit firm is currently or has recently carried out consultancy or advisory work for one of more of the councils conducting the joint procurement • Greater complexity of operational and contractual arrangements to set up and manage 	<ul style="list-style-type: none"> • Individual elected members have less opportunity for direct involvement in the appointment process • Councils will need to opt-in before contract prices are known • Audit fees are agreed by PSAA not the County Council • The contract is managed by PSAA • Procurement evaluation criteria set by PSAA rather than the County Council (e.g. PSAA has defined a relative price:quality weighting of 20:80)

¹ Hampshire and Isle of Wight Fire and Rescue Authority, Police and Crime Commissioner for Hampshire, Hampshire Constabulary

Consultation and Equalities

43. The Local Audit and Accountability Act 2014 sets out that the accounts of a relevant authority must be audited in accordance with the Act by an auditor appointed in accordance with the Act. The Act sets out routes authorities may follow to procure and appoint an auditor and this report provides details of those routes for consideration. This is a statutory requirement and no consultation or Equalities Impact Assessments are required.

Conclusions

44. The County Council must comply with the requirements of the Local Audit and Accountability Act 2014 in appointing independent external auditors. There are three main routes available to local authorities in making these appointments, each of which bring their own advantages and disadvantages. These advantages and disadvantages need to be weighed up in making a decision on which route to recommend to Full Council for the appointment of auditors for the 5 year period beginning April 2023. Any decision to opt-in to the national scheme through Public Sector Audit Appointments Limited (PSAA) must be made by 11 March 2022. If the County Council does not opt-in to this scheme then it will need to appoint an auditor panel and begin a procurement exercise to appoint auditors no later than 31 December 2022. This could be individually or jointly with other authorities.

REQUIRED CORPORATE AND LEGAL INFORMATION:

Links to the Strategic Plan

This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because:

It relates to the effective governance of the County Council

Other Significant Links

Links to previous Member decisions:

<u>Title</u>	<u>Date</u>
Local Audit and Accountability Act 2014 - Update	5/2/15
Local Appointment of external auditors - update	23/6/16
Local Appointment of External Auditors - Update	29/9/16
Appointment of external auditors	24/11/16

Direct links to specific legislation or Government Directives

<u>Title</u>	<u>Date</u>
Local Audit and Accountability Act 2014 (legislation.gov.uk)	
The Local Audit (Auditor Panel Independence) Regulations 2014 (legislation.gov.uk)	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

<u>Document</u>	<u>Location</u>
None	

EQUALITIES IMPACT ASSESSMENT:

1. Equality Duty

The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant protected characteristic that are connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic that are different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low.

2. Equalities Impact Assessment:

This report relates to the consideration of routes available to the County Council for the appointment of external auditors under the Local Audit and Accountability Act 2014 and there are not considered to be any equality impacts as a result.

Appendix 1

Independence criteria for auditor panels

[The Local Audit \(Auditor Panel Independence\) Regulations 2014](#)
([legislation.gov.uk](#))

(2) A member of a relevant authority's auditor panel, other than a health service body's auditor panel, is "independent" at any given time if the following conditions are met—

- a) the panel member has not been a member or officer of the authority within the period of 5 years ending with that time (the "last 5 years"),
- b) the panel member has not, within the last 5 years, been a member or officer of another relevant authority that is (at the given time) connected with the authority or with which (at the given time) the authority is connected,
- c) the panel member has not, within the last 5 years, been an officer or employee of an entity, other than a relevant authority, that is (at the given time) connected with the authority,
- d) the panel member is not a relative or close friend of—
 - a. a member or officer of the authority,
 - b. a member or officer of another relevant authority that is connected with the authority or with which the authority is connected, or
 - c. an officer or employee of an entity, other than a relevant authority, that is connected with the authority,
- e) the panel member is not the authority's elected mayor,
- f) neither the panel member, nor any body in which the panel member has a beneficial interest, has entered into a contract with the authority—
 - a. under which goods or services are to be provided or works are to be executed, and
 - b. which has not been fully discharged,
- g) the panel member is not a current or prospective auditor of the authority, and
- h) the panel member has not, within the last 5 years, been—
 - a. an employee of a person who is (at the given time) a current or prospective auditor of the authority,
 - b. a partner in a firm that is (at the given time) a current or prospective auditor of the authority, or
 - c. a director of a body corporate that is (at the given time) a current or prospective auditor of the authority.