

PSAA Consultation – Briefing Note

1.0 Introduction

The Public Sector Audit Appointments Limited (PSAA) is an independent company limited by guarantee incorporated by the Local Government Association in August 2014.

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. 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 entered into with the audit firms.

The initial procurement on behalf of more than 480 bodies (98% of those eligible to join the national scheme) was very successful, attracting very competitive bids from firms. As a result PSAA were able to enter into long term contracts covering the period 2018/19 to 2022/23 with five experienced and respected firms and to make auditor appointments to all bodies.

During Autumn 2021 all local government and police bodies will need to make important decisions about their external audit arrangements for the period commencing from the financial year 2023/24. Local bodies 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. PSAA has produced a [draft prospectus](#) which provides an introduction to the national scheme.

2.0 Background

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. Then, in rapid succession, there were 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.

These 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. Some significant change is already underway which has affected audits since 2018/19 where deeper levels of assurance has been required, which requires additional work to be undertaken, ultimately leading to higher charges than initially set.

In addition to the additional work requirements, recruitment challenges and growing complexity within local authority accounts also threaten the ability to meet the 31 July annual audit deadline. Nationally, over two hundred 2018/19 audits missed that deadline. This was further exacerbated in the 2019/20 audit round by Covid-19 despite the government relaxing the timeframe until 30 November with over 260 audits failing to be completed.

PSAA are therefore seeking to coordinate all parties to address these matters. The steps taken so far to improve the process and experience for all parties is included within Appendix 1.

PSAA acknowledge that some of the desirable improvements are outside of their control. However, the prospectus outlines further work to improve the outcomes.

3.0 Draft Prospectus for 2023 and beyond

Although each individual organisation has an option to procure its own audit solution, the PSAA sets out the following benefits of “opting-in” to its procurement is included within Appendix 2. It should be noted that a decision to become an opted-in authority must be taken by Full Council. Opting out would require our own procurement exercise including the creation of an auditor panel¹ for the selection and appointment of the auditor and the associated contract management.

In the event that the procurement fails to attract sufficient capacity to enable auditor appointments to every opted-in body, there are fall-back options to extend one or more existing contracts for the period spanning 2023/24 and 2024/25. Given the financial implications associated with the additional requirements and required improvements, it is likely that the new scale fees will be considerably higher than within the current contract (albeit that additional charges are already being felt). Therefore, extending the current procurement is not felt to be the right way forward.

PSAA believes it is well placed to run another national procurement on behalf of public sector bodies based on the journey it has been over in the last three years and that their “mass market” route will provide the best value for money and market sustainability. It has experience staff in terms of dealing with procurement, managing contracts and setting fees. As a not-for-profit company, PSAA will minimise their costs and any surplus will be returned to scheme members.

As fees will continue to be pooled meaning that everyone within the scheme will benefit from the prices secured via a competitive procurement process. Fee variations are 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 the regulator (the FRC) increases its requirement on auditors.

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

¹ <https://www.cipfa.org/policy-and-guidance/publications/g/guide-to-auditor-panels-pdf>

completed audits, and fee variations to be managed differently depending on whether they are driven by national or local factors.

Firms will be able to bid for a variety of differently sized contracts so that they can match their available resources and risk appetite to the contract for which they bid. This could lead to 7 – 10 contract lots, graduated in size with the largest being up to 25% of the market compared to 40% at present. This will ultimately be dependent upon the number of members opting-in and should be a balance of geography and a blend of the different authority types.

Bidders will be required to meet appropriate quality standards and to reflect realistic market prices in their tenders. PSAA intend to assess Tenders on an 80:20 split between quality and price in line with other recent public sector audit procurements, compared to the 50:50 split applied in the last round. However, it's recognised that the sector will have views on this and these will be taken into consideration.

The areas of focus to assess the quality will be audit approach, quality assurance arrangements, resourcing, capacity and capability, management of the transition between audit firms and client relationship management and communication. There will also be regular engagement with audit committee chairs and Chief Finance Officers. PSAA propose to underpin our more heavily weighted emphasis on quality with a series of KPIs derived from these areas.

In some cases currently, it is possible that the scale fee doesn't cover the actual cost of the audit, therefore independent research will be carried to explore this risk. Where necessary, a minimum scale fee could be introduced from 2023/24. PSAA envisage the inclusion of mechanisms to adjust scale fees transparently (either up or down) to ensure that both opted-in bodies and contracted suppliers are neither advantaged nor disadvantaged by such changes. Importantly it is hoped this will avoid contingency provisions being built into firms' bids to mitigate risk. PSAA intend to share recent approved fee variations to establish a consistent and informed basis for the submission of tenders.

PSAA will tailor their approach to the procurement to take into account emerging outcomes from Government in response to the four reviews stated above. Where regulatory changes are in train which affect the amount of audit work which suppliers must undertake, firms will be informed as to which developments should be priced into their bids. Other regulatory changes will be addressed through the fee variation process.

The preferred duration of the contract is again five years with an option to extend for one or two years. This enables security for both parties and provides a fall-back should there be issues at the tail end of the contract.

PSAA plan to undertake a restricted procurement process which minimises the costs involved for both parties. This is a two stage process. The first stage is a selection process, where the bidders' capability, capacity and experience to perform the contract is assessed. This means the number of bidders can be reduced at the selection stage. The second stage is when the Invitation to Tender is issued and the

bids are assessed to determine the most economically advantageous tender. Only the shortlisted bidders are then invited to submit a tender.

PSAA are considering establish a Dynamic Purchasing System (DPS) in parallel to the main procurement. A DPS could provide the option for some or all subsequent auditor appointments, e.g. to newly established bodies, to be the subject of mini-procurements. It would also mitigate the risk that some audit firms might be “locked out” of the market for the new contract term if they are unsuccessful in the procurement.

To support the drive for market sustainability, PSAA are considering the following possible options:

- accepting consortia bids including those that involve firms which are seeking to enter the market by gaining experience working in partnership with an existing registered supplier;
- accepting bids from firms that are currently proceeding through the local audit registration process; and
- inclusion of one or two lots specifically aimed at seeking to encourage additional capacity into the market, mostly likely through some form of joint working arrangement between more experienced suppliers and new entrants or less experienced suppliers.

Additional costs may arise as an inevitable consequence of striving to bring new suppliers into the market. If additional costs were to occur, they would be borne by the scheme as a whole rather than by an individual audited body or a sub-set of bodies.

The Social Value Act 2012 applies to PSAA, therefore they must consider:

- how the audit services might “improve the social, economic and environmental well-being” of England; and
- how in conducting the process of procurement of those services we might act with a view to securing that improvement.

As such PSAA are considering whether to focus the approach to social value solely on audit apprenticeships which demonstrate a commitment to local audit and are awarded to residents of deprived areas. PSAA feel this focus, whilst narrow, would deliver a tangible, measurable outcome for the long-term benefit of the sector and increase the overall number of apprenticeships. The initial thinking is to attach a 4% evaluation weighting to social value (that equates to 5% of the quality score). Again, it's recognised that the sector will have views on this and these will be taken into consideration.

4.0 Timeframe

PSAA expect to issue with the formal opt-in invitation during September 2021. Following the conclusion of the opt-in invitation period (likely to be during January 2022) there may be one further limited revision of the procurement strategy, depending upon the number of bodies that decide to opt-in and the impact of any potential changes to regulations or other environmental factors. PSAA anticipate initiating the procurement for new audit services contracts in February 2022, culminating in contracts being awarded in June 2022.

The consultation on the draft prospectus will close on Thursday 8 July 2021.

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Appendix 1 – Measures taken to date to improve matters

- proactively and constructively engaging with the numerous high-profile industry reviews, including the significant Redmond Review into Local Authority Financial Reporting and External Audit;
- commissioning an independent review undertaken by Cardiff Business School of the design and implementation of the appointing person role to help shape the thinking about future arrangements;
- commissioning an independent review by consultancy firm Touchstone Renard of the sustainability of the local government audit market, which identified a number of distinctive challenges in the current local audit market. PSAA published the report to inform debate and support ongoing work to strengthen the system and help to deliver long term sustainability;
- working with MHCLG to identify ways to address concerns about fees by developing a new approach to fee variations which would seek wherever possible to determine additional fees at a national level where changes in audit work apply to all or most opted-in bodies;
- the establishment of a Local Audit Quality Forum, which is free of charge to opted-in bodies and has to date held five well attended events on relevant topics;
- using advisory panels and attending meetings of the various Treasurers' Societies and S151 officer meetings to share updates on PSAA's work, discuss audit-related developments, and listen to feedback;
- maintaining contact with those registered audit firms that are not currently contracted with us, to build relationships and understand their thinking on working within the local audit market;
- undertaking research to enable a better understanding of the outcomes of electors' objections and statements of reasons issued since PSAA's establishment in April 2015; and
- sharing experiences with and learning from other organisations that commission local audit services such as Audit Scotland, the NAO, and Crown Commercial Services.

Appendix 2 – Benefits of opting in to PSAA national procurement scheme

- transparent and independent auditor appointment via a third party;
- the best opportunity to secure the appointment of a qualified, registered auditor;
- appointment, if possible, of the same auditors to bodies involved in significant collaboration/joint working initiatives, if the parties believe that it will enhance efficiency and value for money;
- on-going management of any independence issues which may arise;
- access to a dedicated team with significant experience of working within the context of the relevant regulations to appoint auditors, managing contracts with audit firms, and setting and determining audit fees;
- a value for money offer based on minimising PSAA costs and distribution of any surpluses to scheme members;
- collective savings for the sector through undertaking one major procurement as opposed to a multiplicity of smaller procurements;
- a sector-led collaborative scheme supported by an established advisory panel of sector representatives to help inform the design and operation of the scheme;
- avoiding the necessity for local bodies to establish an auditor panel and undertake an auditor procurement, enabling time and resources to be deployed on other pressing priorities;
- providing regular updates to Section 151 officers on a range of local audit related matters and PSAA work, to inform and support effective auditor-audited body relationships; and
- concerted efforts to develop a more sustainable local audit market

Appendix 3 – Consultation Questions and Proposed Answers

1. Is PSAA right to prioritise the awarding of new longer term contracts with firms, based on realistic market bid prices, mitigating the risks of a less than fully successful procurement by holding in reserve the option to extend one or more of the existing audit services contracts for up to two years if required?

Yes, longer term contracts offer greater stability, both in terms of consistency in appointed auditor and their associated fees. Realistic market prices are important to enable the contractor to undertake the work robustly and to avoid the current issues around additional fees being proposed.

However, tight control needs to be had over what constitutes market price to ensure the public purse is not exploited and continues to receive value for money.

The option to extend is also sensible to avoid the issues outlined in the consultation around failure to secure future contractors. However, doing this in agreement with the supplier still leaves an option for them to walk away and thereby negating the desired benefit and leaving the sector exposed.

2. Is five years an appropriate term for bodies to sign up to scheme membership?

Yes

3. Is five years with the option to extend for up to two years subject to the supplier's agreement an appropriate term for the next audit services contracts?

Yes – see the caveat raised in the response to Q1. To fully mitigate the risk the extension should be at PSAA's discretion, not in agreement with the supplier.

4. Is PSAA right to evaluate tender submissions on the basis of 80% quality and 20% price to align with market expectations and other recent public sector audit procurements?

Quality should be the priority. However value for money is also a key consideration. At 80%, there is concern that the supplier will seek to maximise the fees. This would undo the financial savings achieved over the last procurement and add additional pressure onto already stretched local authority budgets. A more balanced approach of say 70:30 in favour of quality feels more sensible.

5. Is PSAA right to seek to encourage market sustainability within the local audit market by accepting bids from firms that are currently proceeding through the local audit registration process; by accepting consortia bids which may involve an unregistered firm gaining experience by working alongside a registered

firm; and by considering the inclusion of one or two lots specifically aimed at seeking to encourage additional capacity into the market?

Yes, without doing so, an already small market could retract further leaving only possibly multinational firms who could monopolise the market. Entry to that market by new firms, or future re-entry by existing firms would be severely compromised.

Where unregistered companies are successful through a consortia, measures should be included to ensure the main registered firm will step in should difficulties arise.

6. Is PSAA's proposed approach to social value appropriate given the services to be procured will be delivered across the whole of England? Are there any alternative approaches that should be considered?

The inclusion of social value elements is the correct thing to do. The considered apprenticeship approach is sensible. Other aspects that could be considered include the supplier committing to reducing their carbon footprint in line with public sector commitments.

It is indicated that suppliers may be considered based upon their locality. Therefore, their contribution to the local community (broader than simply the apprenticeship scheme) could also be considered.

7. Is PSAA right to carry out research and to consider setting a minimum audit fee in the next appointing period, recognising the increasing level of audit work now required and the risk that smaller scale fees may not be sufficient to cover the actual cost of the audit? What would be the key issues for PSAA to consider in the event that it opts to set a minimum fee for a Code-compliant audit?

Yes market research is essential to avoid the suppliers maximising their fee and to ensure the public purse is protected. The minimum fee does give assurance to bidders that their costs could be fully covered. However, a minimum fee offers little protection to local authorities that further charges would not transpire. Perhaps a maximum fee approach or cap could be considered – based on the research. This should still protect the bidder, but also offer assurance to the sector that it is still receiving value for money.

8. In the context of the recent NAO report, should PSAA and other market participants strive to prioritise the timeliness of audit opinions in the next appointing period? What actions should PSAA or other market participants take in order to avoid delayed opinions blighting the next period?

Timeliness is an important factor. In a normal year, where a local authority must complete the draft accounts by the end of May, it is important that the audit follows in a timely manner. Recent examples of audits going on late into autumn or beyond undermine the accounts – they give the impression that there are issues even where there may not be.

PSAA should work to Government to align the audit programme adequately across the whole public sector. Too often audits planned for the beginning of June are affected by overruns in NHS audits. The timeframe for the NHS should be reviewed and set. Once known, the local authority timeframes should be reviewed and set. This may allow greater time to prepare the financial statements, which could improve their quality (although the overwhelming majority receive unqualified opinions indicating quality is not an issue). This will allow all parties to plan and allocate their resource more appropriately, which should reduce workloads and thereby aid the sectors recruitment issues.

A hard statutory deadline could be imposed, as it already is for local authorities to ensure that the audit is complete by the end of September. This allows double the timeframe that local authorities have to prepare the accounts. Conversely, the flexible approach applied to the NHS audit timeframe could be applied to Local Authorities. This does not however resolve the issue that Local Authority resource is distracted for a longer period of time if the audit is stretched over a longer period.

The key ingredient to improve the timeliness of both the production of the Financial Statements and the associated audit is to simplify them. The reporting requirements currently place significant restraints on all parties, and the outcome is too complex for the public to understand.

9. Which specific benefits of the national scheme are most valuable to you? Are there other benefits we should strive to develop?

- Greater value for money than could be achieved through our own procurement exercise.
- Assumed greater range of suppliers attracted to the procurement
- Reduced time in undertaking the procurement.
- Aim to develop a more sustainable market place

10. What are the key issues which will influence your decision about scheme membership for the second appointing period?

- Overall level of sector buy-in and local buy-in
- Proposed minimum fee levels
- Contract length
- Ability of PSAA to adequately contract manage – i.e. with robust contractual measures in place to deal with timeliness, quality and fee increases

11. To inform the further development of our procurement approach, please indicate whether or not you anticipate that your organisation is likely to opt into our scheme?

Yes