

## Delivering a National Scheme for Auditor Appointments to Principal Local Government and Police Bodies

### Introduction

In July 2016 Public Sector Audit Appointments Ltd (PSAA) was selected by the Secretary of State for Communities and Local Government to take on the role of Appointing Person for principal local government and police bodies. This document outlines the nature and scope of an Appointing Person's responsibilities and explains why PSAA is well suited to take on this role. It also provides a detailed progress report on our work to date to ensure that the role delivers significant, tangible benefits for the local bodies which opt into our carefully designed Appointing Person arrangements.

### What is an Appointing Person?

In 2014 the Local Audit and Accountability Act paved the way for a new framework for the audit of local public bodies. The Audit Commission which had previously overseen local audits was abolished; going forward local bodies were to be empowered to appoint their own auditors, subject to a range of safeguards outlined in the Act. Additionally, the Secretary of State for Communities and Local Government was given powers to specify one or more organisations to act as Appointing Persons. This followed successful lobbying by the Local Government Association (LGA), who believed it was in the sector's interests to have in place a sector-led body to procure large contracts and realise the benefits of wide-scale collaboration.

The role of an Appointing Person is to lead the development, implementation and management of a collective scheme for the appointment of local auditors and the setting of associated scale fees. This has the effect of creating choice within the new framework. Local bodies can either organise their own processes to make their own auditor appointment or they can join the collective scheme developed by the selected Appointing Person.

PSAA's Appointing Person brief currently covers a population of 493 public bodies, of which 484 have decided to join our national scheme for an initial five-year opt-in period rather than make their own auditor appointment. The table below provides details of the high levels of participation of each of the relevant types of local bodies:

Body type (including pension fund where applicable)	Number
County councils	27 (100.0%)
London borough councils	32 (97%)
Metropolitan borough councils	34 (94.4%)
Unitary councils	53 (94.6%)
District councils	200 (99.5%)

Body type (including pension fund where applicable)	Number
Fire and rescue authorities	29 (100.0%)
Police bodies (Police and Crime Commissioner and Chief Constable)	73 (97.3%)
Other eligible local government bodies	36 (100.0%)
<b>TOTAL</b>	<b>484 (98.17%)</b>

### Why has PSAA sought to be an Appointing Person?

From the outset we believed that PSAA was uniquely well placed to act as an Appointing Person. The company was established in 2014 specifically to carry out a range of functions to bridge the transition from the former Audit Commission to the new 2014 Act framework. Those functions include making auditor appointments, setting fees, and managing contracts with audit firms. Our staff are therefore well versed in many of the responsibilities which an Appointing Person will carry out. PSAA's governance structure and arrangements are also very appropriate for our new role. We are an independent not-for-profit company, limited by guarantee, formed and hosted by the LGA.

### What are the benefits which PSAA aims to deliver for participating bodies?

In designing PSAA's national Appointing Person scheme our aim has been to deliver a range of real tangible benefits for participating bodies listed below:

- appointment of a qualified, registered, independent auditor in accordance with the duties imposed on PSAA by the Local Audit (Appointing Person) Regulations;
- appointment of the same auditors to bodies involved in significant collaboration or joint working initiatives, where requested by the bodies concerned and possible having regard to issues such as auditor independence;
- on-going management of any auditor independence conflicts or difficulties which may arise;
- a procurement strategy designed to deliver high quality audits, the benefit of bulk buying prices, positive outcomes in terms of social value and a sustainable competitive market for audit services into the future;
- a scale of fees which reflects size, complexity and audit risk and which shares the benefits of competitive prices fairly and proportionately across the sector;
- distribution of any surpluses to participating bodies on a transparent, equitable basis; and
- saving the time and expense of establishing local auditor panels and undertaking separate competitive auditor procurement exercises.

A number of these benefits can already be evidenced in hard measurable terms. For example, PSAA's recent procurement of audit services has resulted in the award of contracts to six firms that are registered as local public auditors. The bid prices secured through this process are expected to result in a reduction of scale fees for all participating bodies of approximately 18%. Over the initial five-year opt-in period that is equivalent to an aggregate saving of more than £30 million for participating bodies.

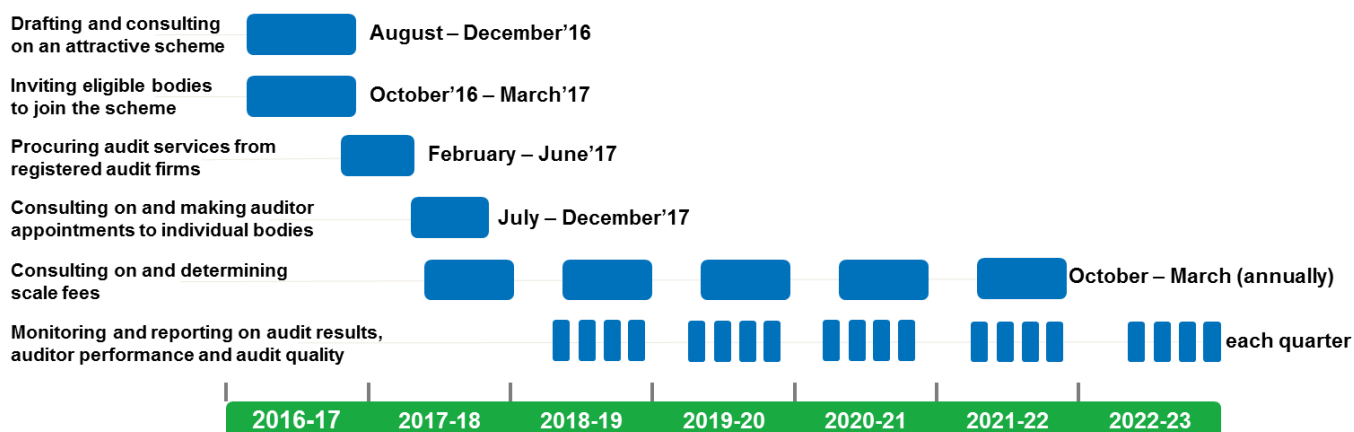
## How is this being implemented?

The project to design and implement PSAA's national scheme has six separate phases:

1. Drafting and consulting on a scheme which is attractive to eligible bodies
2. Inviting eligible bodies to join the scheme
3. Procuring audit services from registered audit firms
4. Consulting on and making auditor appointments to individual bodies
5. Consulting on and determining scale fees
6. Monitoring and reporting on audit results, auditor performance and audit quality

The timetable for completing the implementation of each of these phases is set out below:

## Appointing Person Scheme Timeline



Phases 1, 2 and 3 have already been completed. Phases 4, 5 and 6 will be addressed over the next few months so that all aspects of the scheme are fully implemented and operational by 31 March 2018. The first financial year which will be audited under PSAA's Appointing Person scheme commences on 1 April 2018.

## Progress to date

### Phase 1 - Drafting and consulting on an attractive scheme

Immediately prior to our selection as the Appointing Person we published and consulted on a Prospectus outlining our initial thinking about how the national scheme should operate. The Prospectus was intended to publicise and raise awareness of the new arrangements, and encourage discussion and feedback from audited bodies. This initiative helped us to identify the questions which were being asked by prospective scheme members. It gave us ideas to help further develop and finesse our proposals. It also highlighted the sector's willingness and enthusiasm to work with PSAA to deliver a very attractive scheme.

This work led to a range of visits and discussions with individual bodies or groups of bodies, presentations to a variety of conferences and events, and a well populated *Frequently Asked Questions* section on the PSAA website. It also led to the establishment of the PSAA Advisory

Panel, members of which are drawn from representative organisations for councils, police and fire bodies. The Panel has made an invaluable contribution to our success to date. It has informed and proactively supported the development of the Appointing Person arrangements from the outset, providing an effective two-way channel of communication with the diverse range of principal bodies eligible to opt into the scheme. It has also acted as a sounding board and a source of information and ideas throughout the period of the scheme's development. The Panel will continue to support and advise PSAA as the scheme moves forward and becomes fully operational.

We are happy to receive expressions of interest from additional groups which are not currently represented within the Panel's membership.

We are also indebted to the Local Government Association which has provided tremendous support for PSAA and our national scheme, playing particularly important roles in raising awareness and encouraging bodies to take timely decisions in relation to joining the scheme.

### **Phase 2 - Inviting eligible bodies to join the scheme**

We formally invited all eligible principal local government and police bodies to join the scheme in October 2017. The opt-in invitation period closed on 9 March 2017. We allowed as much time as possible for bodies to inform themselves about the scheme, ask questions and consider options. We were also conscious that bodies would need to make recommendations through their local governance arrangements.

We are delighted that out of a total of 493 bodies eligible to join the scheme, 484 took the decision to opt in for the initial five-year period. Such strong support gives the scheme critical mass to enable it to deliver the optimum results for member bodies.

Eligible bodies which are not currently opted into the scheme can apply to join. We will be happy to consider any requests in accordance with the regulations and will respond with a decision within a period of no more than four weeks. Decisions to admit such applicants to the scheme will specify the financial year from which the body's membership of the scheme will commence.

New principal local government or police bodies that are created after the initial opt-in period, are also entitled to give notice of their intention to join the scheme. In cases of this sort, membership will commence automatically on the date the relevant notice is received by PSAA.

### **Phase 3 - Procuring audit services from registered audit firms**

Audits delivered through the Appointing Person scheme will be carried out by audit firms contracted by PSAA. The work of the firms is subject to regulatory oversight by the Financial Reporting Council. Two Recognised Supervisory Bodies - the Institute of Chartered Accountants in England & Wales (ICAEW) and the Institute of Chartered Accountants of Scotland (ICAS) - are responsible for the licensing, registering and monitoring of auditors who carry out audits of local public bodies.

PSAA's procurement of audit services for the scheme's initial five-year period took place between February and June 2017. Our aims were to maximise value for opted-in bodies by:

- awarding contracts to a sufficient number of firms to enable the appointment of an appropriately qualified auditor, free from any independence conflicts, to every participating body;
- securing the provision of high quality audits by suitably experienced, registered firms;
- incentivising suppliers to submit highly competitive prices; and
- supporting a long-term competitive, sustainable market for local public audit services which has value generally for the sector.

We consulted our Advisory Panel and interested audit firms on both the outline and final versions of our strategy to deliver these aims.

Tenders were invited for a five-year contract, which matches the opt-in period for principal bodies. However, the contract includes the option for PSAA to extend the contract by a further two years, if it wishes to do so.

Tenders were evaluated using a model which attached equal weighting to two key criteria: price and quality. We also encouraged firms to identify social value benefits which can be realised through the award of these contracts. Our procurement strategy also included graduated lot sizes in order to try to attract the most attractive and advantageous bids from firms.

The total volume of audit work to be undertaken was divided into six contract lots. The size of lots 1 to 5 was graduated to incentivise competitive bids. In each case the minimum guaranteed quantum of work to be awarded is fixed at 80% of the relevant lot value. A sixth lot was available to enable the appointment of an auditor at any bodies where all of the other successful firms for lots 1 to 5 cannot accept the appointment for independence reasons. This situation is expected to arise very infrequently and therefore there is no minimum guaranteed value of work attached to lot 6.

Successful contractors, together with the estimated lot values, are listed in the table below:

Lot	Winning Tenderer	Estimated annual value
Lot 1	Grant Thornton (UK) LLP	£14,600,000
Lot 2	Ernst & Young LLP	£10,900,000
Lot 3	Mazars LLP	£ 6,600,000
Lot 4	BDO LLP	£ 2,200,000
Lot 5	Deloitte LLP	£ 2,200,000
Lot 6	Consortium of Moore Stephens LLP and Scott-Moncrieff	no guaranteed value

The successful firms have committed to deliver a range of measurable social value benefits including: over 400 new apprentices over a five-year contract term, with activity to target individuals from deprived communities for up to 40% of the total number of apprenticeships; additional volunteer days and funding for local charities; and reduced environmental impact through flexible/home working, audit technology and efficient portfolio allocation, reduced paper

use, electricity consumption and carbon emissions from reduced travel and increased recycling. In addition a Centre for Social Value is proposed to be established in association with sector representatives (for example, the LGA) and other interested parties including business schools. The aim of the Centre would be to promote learning on effective local interventions to reduce economic inequality and improve social mobility and environmental sustainability.

## Looking Forward

### **Phase 4 - Consulting on and making auditor appointments to individual bodies**

PSAA is responsible for appointing auditors to each participating body. However, before doing so we must consult each individual body on the relevant proposal. The regulations require that these appointments should be finalised by 31 December 2017.

In approaching the appointments process our first priority was to ensure auditor independence by clarifying any conflicts which contracted firms may have in relation to the 484 opted-in bodies. We then attempted to develop 'best fit' proposals by having regard to a number of further important aims:

- meeting PSAA's contractual commitments to guarantee minimum values of work for each individual firm depending on the particular contract lot awarded;
- accommodating requests for the appointment of the same auditor from bodies engaged in joint or shared working arrangements;
- ensuring a mixture of different types of audited body within each firm's portfolio;
- minimising travel time/costs by taking account of the location of each firm's principal offices; and
- maintaining a degree of continuity of appointments subject to PSAA's policy of limiting continuous auditor appointments to no more than 15 years other than in exceptional circumstances.

It was possible to satisfy all of these criteria in relation to the vast majority of individual appointments. For example, a challenge in identifying a single audit firm which is free from independence conflicts and therefore able to audit all of the participants in a very large joint working initiative. However, in overall terms we were committed to delivering 'best fit' proposals which met as many of these aims as possible.

Four of the six firms that were successful in our recent procurement are already carrying out local audits under existing contracts with PSAA. This made it easier to strike an appropriate balance between maintaining continuity and introducing change in our overall proposals for auditor appointments.

Our initial proposals for auditor appointments were shared with the relevant contracted firm so that final independence checks were carried out and any new potential conflicts avoided.

The formal consultation with audited bodies is potentially an iterative process. After careful consideration we notified each body of the firm which PSAA proposed to appoint. If the body indicated that it is content with the proposal, the appointment will be confirmed. If the body wished to object to the proposal, it had to do so in writing, setting out its reasons, within the relevant timescale. All objections were carefully examined by PSAA before making a decision.

If an objection was upheld PSAA made an alternative proposal and the consultation process started again. If necessary this sequence will continue through further iterations until a satisfactory appointment is made. In the event that an objection was not upheld, we explained our reasoning. Should an audited body wish to do so, it may make further representations for consideration by the PSAA Board. In such circumstances the Board's decision will be final.

Audit firms were advised of any changes to their prospective portfolios as the consultation process and associated decision making took its course.

PSAA embarked on this process in July 2017 with the aim of completing appointments to all opted-in bodies by the statutory deadline of 31 December 2017. For ease of reference the outline timetable is summarised below:

Activity	Indicative date
Prepare schedule of proposed appointments	By 3 July 2017
PSAA Board approves proposals	By 7 July 2017
Consult firms on proposed schedule of appointments	7 July – 21 July 2017
Make any adjustments needed and prepare for consultation	24 July to 11 August 2017
Consult audited bodies on proposed appointment	14 August – 22 September 2017
Review representations and consult on alternative proposed appointment – iteration 1	23 September – 27 October 2017
Review representations and consult on alternative proposed appointment – iteration 2	28 October – 27 November 2017
PSAA Board approves appointments	14 December 2017
PSAA issues appointment confirmation letters	18 December 2017

## Phase 5 - Consulting on and determining scale fees

PSAA plans to pool the costs of the scheme and charge fees to opted-in bodies in accordance with a published fee scale. Pooling means that all participating bodies will benefit proportionately from the overall results of the audit services procurement.

During the tender process audit firms bid prices from a baseline of the scale fees set for opted-in bodies in respect of 2016/17. Prices therefore reflect the estimated cost of the work at individual bodies and the auditor's assessment of local audit risk and complexity for the baseline year. They assume that opted-in bodies will provide the auditor with complete and materially accurate financial statements, with supporting working papers, within agreed timeframes. Variations from the scale fee may arise where this expectation is not met.

Pooling ensures that the scale fees of an individual body are not directly affected by the prices bid by the particular firm appointed to audit that body. In all cases fees will reflect the aggregate pooled costs of the scheme.

Because PSAA is a not-for-profit company it does not aim to generate surpluses. However, if in the course of our activities any surplus funds are accumulated we will return them to opted-in bodies on a fair and proportionate basis.

PSAA will only vary scale fees if the auditor's work turns out to be substantially more or less than envisaged by the original scale fee or the firm is required to carry out work in relation to the statutory functions entrusted to the auditor by the Local Audit and Accountability Act 2014. If such a variation is proposed, we will seek an explanation as to its cause from the appointed auditor and consult the audited body before agreeing to any variation to the scale fee.

Variations to scale fees which relate to objections to the accounts will reflect work required from the point at which the auditor formally accepts that a valid objection which requires investigation has been received.

We will review the scale fees for opted-in bodies, alongside the requirements of the audit work programme, each year. Audited bodies and other interested parties will be consulted on the conclusions which emerge from this process. The outline timetable for the 2018/19 consultation is summarised below for information.

Activity	Target date
Consultation on proposed scale fees with opted-in bodies	December 2017 to January 2018
Scale fees approved by PSAA Board and confirmed to opted-in bodies	By 31 March 2018
Start date for auditor appointments for 2018/19	1 April 2018

Based on the bid prices of successful tenderers we currently expect the 2018/19 fee consultation to propose scale fee reductions of the order of 18% compared to the 2017/18 fee levels.

### **Phase 6 - Monitoring and reporting on audit results, auditor performance and audit quality**

By its nature, public sector audit is specialised, reflecting the complex legal, governance and financial control framework in which local government and police bodies operate. All of our work has regard to this environment and the resulting distinctive scope of the audit which includes features such as the auditor's opinion on value for money arrangements, probity and legality issues, reporting in the public interest, and dealing with electors' rights.

Following the completion of the audits for any given year, PSAA will publish a report summarising the results of those audits for all opted-in bodies, where appropriate making comparisons with prior years which may potentially enable early detection of any significant new trends affecting stewardship of public funds, auditor performance or audit quality. If possible we will obtain information from non-member bodies so that our report can reflect the sector-wide position.



PSAA will also liaise closely with the Recognised Supervisory Bodies and the Financial Reporting Council to ensure that any concerns they may have about auditor performance and/or audit quality are detected at an early stage and addressed effectively. We intend to take a close interest in feedback from audited bodies and in the rigour and effectiveness of firms' own quality assurance arrangements, recognising that these represent some of the earliest and most important safety nets for identifying and remedying problems. We will also liaise closely with the National Audit Office to share information to support the local audit regime.

In order to ensure that our approach to managing quality is as effective as possible we have already adopted the International Auditing and Assurance Standards Board's (IAASB) [Framework for Audit Quality](#). In the context of this model we plan to collect and report information concerning the quality of audits undertaken and the performance of auditors, placing emphasis on three key areas:

1. adherence to professional standards and guidance;
2. relationship management; and
3. delivery of method statements derived from the firms' tender submissions covering continuing professional development of staff, quality assurance arrangements, resourcing including contact partner and team selection, use of statutory powers, transitioning between firms and social value gains.

We have already shared some of our initial thinking in relation to quality and performance monitoring and reporting with the PSAA Advisory Panel and will discuss detailed proposals with the Panel during Autumn 2017.

We will also maintain controls in relation to the nature and volume of non-audit services provided by the audit firm to the audited body. Such services encompass any work that is not required to carry out the audit in accordance with the NAO Code of Audit Practice. Non-audit work is recognised as a potential threat to auditor independence if not carefully controlled

Provision of non-audit services is allowable within the framework set by the FRC Ethical Standard, the NAO's Guidance to Auditors and PSAA's Terms of Appointment, subject to specified constraints.

We plan to mitigate any risks to auditor independence arising from non-audit services by employing the following control arrangements:

- below a de minimis value threshold, set annually by PSAA for the relevant financial year, bodies will be able to commission non-audit services from firms without any requirement for firms to refer to PSAA;
- above the de minimis threshold, firms will be required to seek agreement from PSAA that the proposed engagement is not an impediment to independence.
- an absolute cap will be set on the value of non-audit services provided to an audited body in any single financial year. The cap will be equivalent to 70% of the relevant scale fee for that year.

These arrangements are not intended to lessen or displace audit firms' own responsibilities under professional standards to consider independence issues in respect of all non-audit services whatever their nature or value.

The results of PSAA's work to monitor and make assessments of audit quality and auditor performance will be published on the PSAA website at regular intervals, together with information about the value of non-audit services provided by each firm.

### **Keeping you informed**

From time to time this document will be revised and updated as further milestones are reached and progress made towards the implementation of the arrangements outlined. In the meantime, if you have any questions or require any information about PSAA's Appointing Person scheme, please contact us.

### **Further information**

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### **Board Members**

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Clive Grace, former Deputy Auditor General Wales

Stephen Sellers, Solicitor, Gowling WLG (UK) LLP

### **Chief Officer**

Jon Hayes, former Associate Controller Audit Commission