

# **Audit services procurement strategy 2022**

**September 2021 (Revised January 2022)**

**High quality independent audit is one of the cornerstones of public accountability. It gives assurance that taxpayers' money has been well managed and properly expended. It helps to inspire trust and confidence in the organisations and people responsible for managing public money.**

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## Introduction

1. Public Sector Audit Appointments Limited (PSAA) is an independent company limited by guarantee incorporated by the Local Government Association (LGA) in August 2014. It has a Board of non-executive directors supported by a Chief Executive and a team of staff who have significant experience and skills in managing contracts for public audit services. More information about the PSAA Board and Executive team can be found at <http://www.psaa.co.uk/about-us/who-we-are/>.
2. 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, under the provisions of the Local Audit and Accountability Act 2014 (the Act) and the Local Audit (Appointing Person) Regulations 2015 (the Regulations). Acting in accordance with this role PSAA is responsible for appointing an auditor 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 we enter into with the audit firms.
3. During the next few months all eligible bodies will need to make important decisions about their external audit arrangements for the period commencing from the financial year 2023/24.
4. In relation to appointing auditors, 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 managed by PSAA.
5. Events since 2018 have resulted in an audit industry that is under enormous pressure and the local audit system is experiencing its share of the strain and unavoidable instability as impacts cascade down to the frontline of individual audits.
6. We believe that PSAA's national scheme offers the best option for local bodies to secure the appointment of appropriately qualified auditors in the current challenging market conditions. The Local Government Association and MHCLG<sup>1</sup> have expressed similar views.

## Background to the procurement

7. One of PSAA's most important obligations is to make an appropriate auditor appointment to each and every opted-in body. Prior to making appointments for the second appointing period, commencing on 1 April 2023, we plan to undertake a major procurement enabling suppliers to enter into new long term contracts with PSAA.

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<sup>1</sup> Immediately prior to the publication of this document it was announced that MHCLG has been renamed to Department for Levelling Up, Housing and Communities (DLUHC). The document refers to the department as MHCLG.

8. In the event that the procurement fails to attract sufficient capacity to enable auditor appointments to every opted-in body, we have the option to extend one or more existing contracts for 2023/24 and also 2024/25 in order to secure or supplement capacity.
9. PSAA is intent on having a successful procurement and being able to award contract opportunities to successful bidders at the conclusion of the process.
10. However, PSAA explicitly reserves the right to exercise its discretion to abandon the procurement for one or more lots including all of the lots where PSAA, at its sole discretion, considers the procurement has not sufficiently delivered to a suitable level one or more of the stated procurement strategy objectives, for example where it has not delivered sufficient value for opted-in bodies.
11. The factors (and the interaction of factors) that PSAA will take into account amongst its considerations of whether to award a lot will include (but not be limited to):
  - the impact on overall sustainability of the local government audit provider market;
  - the relative value for money for opted-in bodies of provisional winning tenders across all lots, which will be informed by the relative quality offered and the degree to which the bid rates are greater or less than the bid rates of other provisional lot winners; and
  - any government, system leader, regulatory or other policy announcements or clarifications relevant to the exercise of PSAA's functions.
12. MHCLG's Spring statement proposed changes to the current arrangements. At the time of writing, the response to the formal consultation on the proposals in the Spring statement is awaited. Following the publication of its response to the consultation on changes to the Local Audit (Appointing Person) Regulations 2015, in Autumn 2021 the government is in the final stage of introducing secondary legislation to provide the appointing person with greater flexibility to allow a fee scale to be set during the audit year. These changes enable approved recurring fee variations to be baked into the scale fee at an earlier date so the scale fees are more accurate and the volume of fee variations is reduced.
13. PSAA has set the length of the next compulsory appointing period to cover the audits of the five consecutive financial years commencing 1 April 2023.
14. PSAA needs to enter into new contracts with audit firms in order to make auditor appointments to opted-in bodies by 31 December 2022, as required by the Appointing Person Regulations. This procurement strategy sets out our current plans for the basis on which the procurement of audit services will be carried out.

### **Objectives of the procurement**

15. Our 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.

16. The objectives of the procurement are to maximise value for local public bodies by:
- securing the delivery of independent audit services of the required quality;
  - awarding long term contracts to a sufficient number of firms to enable the deployment of an appropriately qualified auditing team to every participating body;
  - encouraging existing suppliers to remain active participants in local audit and creating opportunities for new suppliers to enter the market;
  - encouraging audit suppliers to submit prices which are realistic in the context of the current market;
  - enabling auditor appointments which facilitate the efficient use of audit resources;
  - supporting and contributing to the efforts of audited bodies and auditors to improve the timeliness of audit opinion delivery; and
  - establishing arrangements that are able to evolve in response to changes to the local audit framework.
17. It is necessary to enter into contracts with a number of audit suppliers to provide sufficient capacity for all of the audits required, enable PSAA to manage auditor independence issues and, if possible, grow the number of active suppliers in the local audit market.

### **Scope of the procurement**

18. The procurement will cover the audits of the accounts of all eligible bodies that opt into the appointing person scheme. Eligible bodies include local authorities, combined authorities, police and crime commissioners including PFCCs, chief constables, fire and rescue authorities, waste authorities, passenger transport executives and national park authorities.
19. There are currently 476 eligible bodies that will receive invitations to opt into the appointing person arrangements during September 2021. This number may reduce slightly from 1 April 2023 given the planned reorganisation in the counties of Cumbria, North Yorkshire, and Somerset. The closing date for acceptance of the opt-in invitation is 11 March 2022. We expect to receive acceptances from eligible bodies throughout the opt-in period and will maintain and publish an up to date record of bodies joining the scheme on the PSAA website.
20. PSAA has allowed a considerably longer period during which an eligible body can opt in compared to the statutory minimum period of eight weeks. It is hoped this will enable eligible bodies to meet the requirement under the regulations to make the decision to opt in at a full council meeting. (As corporations sole, the full council requirement does not apply to police and crime commissioners and police, fire and crime commissioners).
21. In order to maximise the potential economies of scale for eligible bodies as a result of entering into large contracts with firms, and to manage any auditor independence issues,

PSAA will seek to provide as much clarity and certainty as possible concerning the volume and nature of audits it is able to offer to firms.

### Evolution of this strategy

22. This strategy has been developed based on our knowledge and experience of previous procurements for audit and related services, including the lessons learned from our 2017 procurement and the research we have commissioned since that time. Importantly it has been shaped by the feedback received to the market engagement exercise and consultation with eligible bodies, which we undertook in June 2021. [A summary of the response to PSAA's consultation and market engagement](#) has been published.
23. PSAA has produced a risk allocation matrix (attached as an appendix) to inform the development of its commercial model and pricing approach as described in this strategy. It sets out PSAA's assessment of the risks that each party is required to bear so provision can be made to mitigate and manage these risks in the most effective and economical manner.
24. This revised procurement strategy was agreed by the PSAA Board on 31 January 2022. The few amendments made reflect recent developments in our proposed approach and in the local audit world. (It supersedes the version agreed on 15 September 2021, which was shared and discussed with members of the Liaison Committee chaired by MHCLG and involving representatives of FRC, NAO, CIPFA, ICAEW and the LGA). In a number of areas feedback has helped us to evolve our thinking on the procurement characteristics outlined in the June 2021 draft prospectus and market engagement documents.
25. Two market briefings were held – in November 2021 and January 2022 – to explain and answer questions about our procurement strategy.
26. We expect to publish the contract notice on 7 February 2022. From that point forward, all engagement in respect of the procurement will be conducted in accordance with the arrangements described in the procurement documentation.
27. The significant work to reform audit in the wake of the four government reviews (Kingman's review of the FRC; the Competition and Markets Authority review of the audit market; Sir Donald Brydon's review of the quality and effectiveness of audit; and Sir Tony Redmond's review of local authority financial reporting and external audit) is underway.
28. Further wide-ranging change is almost certain to occur during the next few years, and is very likely to have an impact during the appointing period that will commence in April 2023. Alongside changes to the general and local audit framework, the Government is reviewing the public sector procurement regulations, following the UK's withdrawal from the European Union.

## The procurement strategy

### The procurement route

29. The Public Contract Regulations 2015 (the Contract Regulations) will apply to the procurement and it will be carried out in accordance with those Regulations.

### Choice of procurement procedure

30. PSAA is keen, if possible, to enter into contracts with a larger number of suppliers registered as local public auditors than the current five. This could include a non-registered firm working with a registered firm.
31. This will give PSAA the ability to manage auditor independence issues, for example, where an audit supplier has a pre-existing relationship with an opted-in body which prevents it from accepting an audit appointment. It will also provide the flexibility to enable PSAA to respond to the significant number of joint or shared working arrangements for which partner eligible bodies often express a preference for the appointment of a common audit supplier. By entering into contracts with a number of suppliers, PSAA will help to support the drive towards a long term competitive and more sustainable market for local public audit services.
32. Because the nature of the services being procured is highly specialised, PSAA will follow the restricted procedure (rather than the open procedure) in accordance with the Contract Regulations. This will enable PSAA to identify those suppliers with the necessary financial standing, technical capability, skills and experience to provide services and then invite all those shortlisted to tender.
33. Bids will be accepted from suppliers which are registered as, or that are currently proceeding through the registration process to become, a local public auditor with a supervisory body approved by the Financial Reporting Council, currently the Institute of Chartered Accountants in England and Wales (ICAEW). The registration and ongoing monitoring processes test supplier quality and competence. A potential supplier that is not registered as a local public auditor is encouraged to have an early discussion with one of the Recognised Supervisory Bodies.
34. Bids from consortia or other forms of joint working arrangements will be permitted where at least one member organisation within the consortium or arrangements is individually registered as (or going through the process of registration to become) a local public auditor with the ICAEW.
35. PSAA is only able to contract with accredited suppliers. A contract award made to a supplier going through the registration process will be conditional on the ICAEW, as the Recognised Supervisory Body, approving their registration and the procurement will not seek to prejudice ICAEW's approval process.
36. Suppliers invited to tender will be asked to quote prices for a contract length of five years, which matches the opt-in period for eligible bodies. The contracts will include the option to extend the contract duration by up to a further two years, by mutual agreement.



37. Variant bids will not be permitted.

### **Contract lots**

38. PSAA will structure its procurement and invite bids as set out in the paragraphs below, subject to confirmation once the number of eligible bodies opting into the scheme is known.
39. There will be a single England-wide contract area, containing between 10 “standard” lots. There will also be a further three lots which will be classed as “development” lots.
40. The size of the lots will be graduated to enable bidders to match their capacity and risk appetite with their preferred lot size. The “standard” lots will be sized from around 18% to 4% of the portfolio of opted-in bodies.
41. The three “development” lots will be sized at around 2.25% (two lots) and 0.5% (one lot) of the portfolio of opted-in bodies in order to encourage new entrants.
42. The number of individual lots and their indicative value will be clearly set out in the invitation to tender. PSAA will reserve the right to award work in excess of the lot size as a mitigation should we be unable to award all lots.
43. For each individual lot, PSAA will give an indication of the minimum volume of work which the lot will contain.
44. There will be no requirement for bidders to participate in joint audits.
45. Except for the “development” lots, each lot in its final form will reflect a sensible balance of geography and a blend of the different authority types, taking account of the guiding principles used when making auditor appointments as set out in para 50 below. Only the six largest lots will include one or more public interest entity (PIE) audits. In addition the three development lots will exclude any audits of Unitary Councils, Metropolitan Borough Councils, London Borough Councils and County Councils.
46. The indicative value of each lot will be expressed by reference to the ‘audited body notional value’ (ABNV), which comprises the published scale fees for 2021/22 for all opted-in bodies plus actual and estimated recurring fee variations for 2019/20 audits. This will establish a consistent baseline for bidders’ pricing.
47. Within the invitation to tender we will provide further information that will be helpful to bidders in their consideration of bid prices covering:
  - those future regulatory and Code-related changes up to April 2023 that we expect bidders to reflect in their pricing. Correspondingly, we will identify those possible changes where there is insufficient information available to do so and outline how these will be handled; and

- a schedule of opted-in bodies which details the most recent audit year completed, the scale fee and the nature and value of recurring fee variations that are already baked into the scale fee.
48. Named audits will not be allocated to a lot until the procurement is complete and the subsequent consultation processes with opted-in bodies and successful bidders have taken place. Having a larger number of lots increases the opportunity for a greater proportion of a lot to be concentrated in specific geographical areas rather than being spread across the country.
49. There is no “auditor of last resort” in England, unlike other UK public sector procurers of volume public audit services. Given the statutory nature of audit, and its obligation to make an auditor appointment to every opted-in body, PSAA will endeavour to encourage the market to bid in a manner which represents value for money for the public purse, without damaging sustainability.
50. When making auditor appointments following contract award, PSAA will consider the status of prior years’ audits and will be guided by the following principles:
- ensuring auditor independence;
  - ensuring any contractually guaranteed levels of work are met;
  - ensuring a blend of authority types for each audit firm;
  - taking account of a firm’s principal locations and geographical preferences (as specified in its tender response);
  - providing continuity of audit firm, where appropriate; and
  - accommodating joint/shared working arrangements between local bodies where possible.

### **Bidding rules relating to lots**

51. In the interests of market sustainability, and subject to receiving sufficient bids and to the outcome of the evaluation of responses to the invitation to tender, PSAA expects to award no more than 34% of the aggregate value of its total portfolio (and potentially a lesser maximum percentage) to any single supplier. Ideally PSAA wants to enter into long term contracts with a larger number of suppliers than we do currently, reflecting a more balanced distribution of work. Our lot structure and bidding rules will aim to enable this, subject to us receiving sufficient bids. The exact number of lots that any successful bidder could be awarded will be set out in the procurement documents.
52. Bidders will be required to indicate the maximum amount of work per annum that they are able/would be willing to deliver, as a percentage of PSAA’s total work based on ABNV. Where a bidder submits bids for multiple lots, this information would be used by PSAA to ensure that any bidder is not awarded work in excess of its stated capacity. In the event of PSAA receiving insufficient bids, a supplier may be awarded more than 34% where they indicate they have such capacity.

53. Bidders will not be required to bid for all lots. However, they will be able to bid for all lots which fall within the range which they have specified as their maximum capacity.
54. PSAA will award contracts to a number of suppliers, to enable it to:
  - manage any independence issues that may arise when making auditor appointments to opted-in audited bodies;
  - respond to shared or joint working arrangements between opted-in bodies;
  - make an appropriate auditor appointment to each opted-in body after fulfilling its statutory duty to consult such bodies on proposed appointments; and
  - support the drive for longer-term market sustainability.
55. Contract lots will be awarded to the suppliers submitting the most economically advantageous tenders i.e. assessed using a quality/price ratio.
56. Bidders will be invited to express their bids for each lot as a fixed proportion of the relevant ABNV. Bidders can submit a percentage value that is greater or less than 100%. Bidders will be able to submit different bid rate percentages for each lot.
57. Bidders will have the option to offer two bid rates for each lot: one representing the bid rate if the Lot is their first win, and one representing the bid rate if the Lot becomes a subsequent win. There is no obligation for a bidder to offer a subsequent bid rate to be used in the price evaluation for subsequent Lots following a Lot win.
58. PSAA recognises that the location of an audit is an important consideration for bidders. Bidders for all lots, other than the “development” lots, will therefore be able to select up to four geographical areas which would be least attractive/convenient for them to audit (from a pre-defined list of English County and Combined Authority areas<sup>2</sup>). PSAA would seek to avoid appointing the bidder, if successful, to audits within the selected geographic areas. In the event that it was necessary to appoint the bidder to any audits in those areas, the relevant bid rate would be increased by a premium of 30% in respect of the audits concerned.
59. It is recognised that bidders for the “development” lots may have the capacity to work in a relatively limited geographical area compared to larger suppliers. They will therefore be able to select up to four areas in which they would be able to undertake audits using the same predefined list of English County and Combined Authority areas.

## Audit Fees

60. PSAA strongly believes the national, sector-led, collective scheme offers benefits to both audit services suppliers and eligible bodies. By opting into PSAA’s scheme, individual bodies will avoid the costs of their own procurement and management of contracts and also the requirement to set up an auditor panel with independent members. Audit services suppliers avoid the expense of participating in multiple procurements and,

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<sup>2</sup> Counties (including any Councils or Other Relevant Local Bodies within the County area), and Combined Authorities (including any Councils or Other Relevant Local Bodies within the Combined Authority area)

where successful, the challenge of being subject to and managing a range of different contract management regimes.

61. PSAA's costs of managing the scheme are covered by audit fees paid by opted-in bodies. Over the current contract term, from 2018 to 2023, our annual operating costs have averaged approximately 4% of total annual contract spend. We plan to continue to manage our own costs appropriately and to ensure that the national scheme offers excellent value for its members.
62. PSAA will continue to pool scheme costs and charge fees to opted-in bodies in accordance with our published fee scale as amended from time to time following consultations with scheme members and other interested parties.
63. As a not-for-profit organisation, PSAA returns to opted-in bodies any surplus funds generated by the scheme after all costs have been met. This obligation is set out clearly in our articles of association. Our most recent distribution of surplus funds, totalling £5.6m was announced in August 2021.
64. PSAA expects to make a statement on the impact of the procurement outcome on 2023/24 scale fees following contract award in the second half of 2022.
65. PSAA will consult on the proposed scale of fees for 2023/24 and subsequently expects to publish the fees applicable no later than the end of November 2023, following the amendment to the Appointing Person Regulations which will move the latest date by which audit fees must be set from 31 March to 30 November of the year to which the audit relates.
66. For each year of the contract (apart from year 1), PSAA intends to increase the remuneration paid to its audit firms by reference to the annual increase in CPI.
67. Additional fees (fee variations) are part of the legal framework. They only occur if substantially more or less work is required than is envisaged in the scale fee or the auditor is entitled to recover costs or expenses from the audited body under specific provisions in the regulations, for example in relation to public interest reports or objection work.
68. The regulations require PSAA to consider every fee variation on a case-by-case basis. Over the past nine months we have made improvements to our internal processes to enable the handling of a larger number of claims and we will continue to review and make improvements where possible for the benefit of all parties.
69. PSAA reviews and robustly assesses each fee variation proposal. We apply our technical knowledge and experience of all audits to assess each submission and can compare with similar submissions for other bodies across all our audit suppliers before reaching a decision. Our process requires that fees for additional work are discussed with and explained to the audited body before they can be proposed to PSAA. The Regulations require that the proposals must be approved by PSAA before they can be invoiced.

- 70. PSAA will provide a copy of the current rate card with the invitation to tender. Each winning bidder will be remunerated for additional work for each lot that it wins at a rate equal to the current rate card multiplied by its bid rate for that particular lot.
- 71. PSAA will update the rate card through the appointing period in line with changes to scale fees that are not related to the level of work – for example, inflation.
- 72. The hourly rates used as part of the determination of the valuation of additional work (fee variations) will continue to be the same for all audited bodies.

### Procurement process

- 73. The key stages in the procurement process are set out below. In accordance with the Contract Regulations, PSAA will ensure that at each stage the process complies with the requirements of equal treatment, non-discrimination, transparency, and proportionality.
- 74. PSAA will use the Delta e-tendering platform to undertake this procurement.

#### Timetable and key milestones

- 75. The timetable and key milestones for the procurement are summarised in Table 1. The target dates are provisional and may be subject to change.

Table 1 – indicative procurement timetable

| Key milestone   | Target Date          |
|---|----------------------|
| Publish Contract Notice and issue documentation on request              | noon 7 February 2022 |
| Deadline for submission of Selection Questionnaires                     | noon 18 March 2022   |
| Issue invitation to tender to short-listed suppliers                    | noon 7 April 2022    |
| Deadline for submission of tenders                                      | noon 11 July 2022    |
| PSAA Board approval of contract awards, assuming a satisfactory outcome | August 2022          |

- 76. Following a statutory consultation process auditor appointment for opted-in bodies will be made by 31 December 2022 for audit years from 2023/24.
- 77. This timetable is consistent with the requirement set out in the Local Audit and Accountability Act 2014, for an authority to appoint an auditor to audit its accounts for a financial year by no later than 31 December in the preceding financial year.

## Contract Notice

78. The purpose and scope of the procurement will be set out in the Contract Notice to be published on the Find A Tender Service and Contracts Finder.

## Pre-qualification (selection) stage

79. The pre-qualification (selection) stage will be designed to enable PSAA to assess potential audit suppliers' ability to meet PSAA's requirements.
80. The selection questionnaire evaluation criteria will be:
- compliance with grounds that would otherwise lead to mandatory or discretionary rejection under the Contract Regulations;
  - satisfactory organisational, financial and economic standing, insurance and information assurance arrangements;
  - capability and capacity;
  - technical and professional knowledge and experience; and
  - eligibility for appointment under the Act and Regulations, either through being registered with ICAEW or going through the process of registration.
81. Evaluation at this stage will result in a pass or fail outcome for each potential supplier. All suppliers achieving a pass outcome will be invited to tender.

## Tender stage

82. The tenders for each lot will be evaluated in accordance with the published evaluation criteria to identify the most economically advantageous tenders. The relative weighting of price and quality will be 20:80 with 5 marks of the 80 quality marks being attributed to social value, which equates to 5% of the overall score. PSAA plan to ask bidders to describe the additional social value they will deliver from the contract, which could include the creation of audit apprenticeships and meaningful training opportunities. Bidders will also be asked to describe how their delivery of social value will be measured and evidenced.
83. The quality of responses at tender stage will be assessed against a range of relevant criteria such as audit approach, quality assurance, client communications and resourcing and capacity & capability including sector knowledge. Aligned with the Government's proposal that the ARGA become the local audit system leader, we sought the FRC's input in developing our approach.
84. Bidders will only be requested to provide one response to the quality section of the tender irrespective of the number of contract lots they bid for, although some questions may require a lot-specific response. The "development" lots will be assessed against the same criteria as the "standard" lots.
85. The formal tender evaluation criteria and methodology will be described in the invitation to tender documentation, and published on the PSAA website.

## Establishment of a Dynamic Purchasing System (DPS)

86. Alongside the publication of a Contract Notice for the main audit services procurement outlined above, PSAA will publish a second, separate Contract Notice to establish a DPS.
87. The form of selection questionnaire (SQ) used to apply to participate in the DPS will be the same as the one used for the main audit services procurement. Potential Suppliers who wish to express an interest in both the DPS and main procurement opportunities at the same time, they will only need to complete a single SQ response. However the completed SQ response will need to be separately uploaded to each procurement opportunity in the Delta e-tendering platform.
88. Once the DPS is established, a supplier that is not a member of the DPS (e.g. a new supplier to the local audit market) can apply to join at any point during the DPS's period of validity if they satisfy the selection requirements, and none of the grounds for exclusion apply. PSAA would evaluate the supplier's selection questionnaire within the legally required timescale of 10 working days of receipt unless there are justifiable reasons for an extension.
89. The establishment of a DPS has the potential to offer several benefits over the life of the term of the contracts awarded from the main audit services procurement:
  - provide an alternative to the current practice of automatically seeking to distribute additional audits between contracted firms, for example, in the event of local government reorganisation, or if existing bodies request to join the scheme after the initial opt-in invitation and procurement processes;
  - enable suppliers who are not awarded a contract from the main audit services procurement to bid for PSAA work, so they are not "locked out" (and provide winning suppliers the opportunity to bid for further audits);
  - enable consideration of different contract durations and the potential to stagger future tenders; and
  - should any of the 2017 audit services contracts need to be extended, provide a mechanism through which to undertake the procurement of services for the audits beyond 2023/24 or 2024/25.
90. Additionally, the DPS will provide a potential option in the event of not receiving sufficient bids to the main audit services procurement.
91. PSAA do not intend to use the DPS to procure replacements for auditor appointments made as part of the 2022 contract award before the end of the contract's duration unless there is a specific reason for doing so. Such reasons might include the identification of an independence conflict, the breakdown of auditor-audited body relationship, or as a result of a supplier's poor performance in line with agreed contract terms.
92. The key characteristics of any procurement undertaken through the DPS are likely to be very similar to those used for the main procurement. Clearly there will also need to be some differences, for example, to reflect that a DPS procurement may be for an individual audit, small group of audits or a more significant volume of work. All

procurement documentation will be available when the Contract Notice for the DPS is published at the same time as the Contract Notice for the main procurement in early February 2022.

93. PSAA expect the DPS to become operational during May 2022, and intend to maintain it throughout the next contract period.



## Appendix - Risk Allocation Matrix

### Introduction

The allocation and management of risk is central to all commercial contracts and is one of the core commercial principles informing the approach to contracting with third parties. Each party seeks to minimise its overall risk and maximise its reward, which creates an inherent tension between contracting parties. Effectiveness and value for money of contracted services will only be achieved where risk allocation is appropriate and where the party managing the risk is the one most reasonably able to do so.

### Purpose

PSAA produced this risk allocation matrix to inform the development of its commercial model and pricing approach for contract of audit services to deliver the national scheme for local auditor appointments from April 2023. It sets out PSAA's assessment of the risks that each party is required to bear so provision can be made to mitigate and manage these risks in the most effective and economical manner.

### Review

The risk allocation matrix will be reviewed periodically up to the point that the procurement is initiated where appropriate in the light of comments from audit firms and to ensure that it reflects the emergence of new information and any changes in circumstances.

### Risk Allocation Matrix

| Risk id | Risk Category   | Explanatory comments   | Potential risk allocation                          |             |
|---------|---|--|--|-------------|
|         |   |  | PSAA   | Audit Firms |
| 1.      | <b>Data inaccuracy</b><br>Risk that inaccurate (or incomplete) data is provided to bidders during the procurement exercise leading to inaccurate pricing or solution. | <ul style="list-style-type: none"> <li>PSAA will make available the latest information about the audits at the commencement of the procurement, e.g. the most recent audit year completed, the scale fee and the nature and extent of recurring fee variations that are already baked into the scale fee but do not warrant the accuracy of this information. PSAA will adjust the ABNV to reflect any inaccuracies subsequently discovered in this information (see 12 below).</li> </ul> | <ul style="list-style-type: none"> <li></li> </ul> |             |
| 2.      | <b>Inflation</b><br>Risk that the cost of supplier's inputs will rise over time due to inflation.   | <ul style="list-style-type: none"> <li>The contract will provide indexation on the price paid to audit firms based on the annual application of the prevailing rate of CPI (apart from year 1).</li> <li>There is also an inflation risk for the audit firm; the cost pressures they experience may exceed their estimates and any allowance provided by an index-based adjustment.</li> </ul>   | <b>shared</b>                                      |             |

## Risk Allocation Matrix

| Risk id | Risk Category   | Explanatory comments  | Potential risk allocation |             |
|---------|---|---|---------------------------|-------------|
|         |   |   | PSAA                      | Audit Firms |
| 3.      | <b>Performance / availability</b><br>Risk that the service will not be delivered to the requisite performance/availability levels.                                    | <ul style="list-style-type: none"> <li>Audit firms must deliver the service in accordance with the NAO's Code of Audit Practice and all regulatory requirements e.g. of the FRC.</li> <li>The contract will include a performance measure that relates to the audit firm's stated capacity to deliver to a number of audits equal in value to the lot size plus a margin (say 5% of the lot size) for audits awarded before the end of 2022. The availability of sufficient audit resources is a supplier risk.</li> </ul>  |                           | ●           |
| 4.      | <b>Volume /demand</b><br>Risk that the actual usage of the service is less than the guaranteed minimum.   | <ul style="list-style-type: none"> <li>Local bodies that decide to opt into PSAA's scheme are then statutorily committed to remain in the scheme for the full appointing period of five years, unless they are abolished under local government reorganisation.</li> <li>Contractual provision will guarantee a minimum volume of work.</li> </ul>  | ●                         |             |
| 5.      | <b>Volume /demand</b><br>Risk that the actual usage of the service is greater than the lot size plus a small margin (say 5%) for audit awards before the end of 2022. | <ul style="list-style-type: none"> <li>PSAA may only award work in excess of this figure with the supplier's agreement.</li> </ul>  | ●                         |             |
| 6.      | <b>Volume/demand</b><br>Substantial additional work.  | <ul style="list-style-type: none"> <li>PSAA will pay for substantial additional work and certain statutory actions as defined in the Appointing Person regulations namely                             <ul style="list-style-type: none"> <li>the consideration of the making of and the making of a public interest report or a written recommendation under Schedule 7 of the 2014 Act;</li> <li>the exercise of any functions under section 27 of the 2014 Act in relation to the right to make objections at the audit;</li> <li>any application to the court under section 28 of the 2014 Act for a declaration that an item of account is contrary to law or any appearance as respondent to any appeal against such a declaration;</li> <li>the consideration of the issue of and any issue of an advisory notice under Schedule 8 of the 2014 Act;</li> <li>any application for judicial review under section 31 of the 2014 Act or any appearance as respondent to any application for judicial review made in respect of the exercise of the auditors' functions.</li> </ul> </li> </ul> | ●                         |             |

## Risk Allocation Matrix

| Risk id | Risk Category   | Explanatory comments   | Potential risk allocation |             |
|---------|---|--|---------------------------|-------------|
|         |   |  | PSAA                      | Audit Firms |
|         |   | <ul style="list-style-type: none"> <li>Substantial additional work will include future regulatory and code related changes unless notified to bidders in the ITT.</li> </ul>   |                           |             |
| 7.      | <b>Change in law</b>  | <ul style="list-style-type: none"> <li>The supplier mostly takes this risk. The supplier shall neither be relieved of its obligations to supply services under the contract nor be entitled to an increase in charges as the result of the general change in law.</li> </ul>   | .                         | ●           |
| 8.      | <p><b>Performance risk</b><br/>Risk that the services have/project has not been planned adequately for the purpose required or are not properly performed.</p> <p>Performance Indicators.</p> | <ul style="list-style-type: none"> <li>Audit firms will have the responsibility for the adequacy of the planning and performance of the service provided and their compliance with the output/performance specification. The scope of local audit is fixed by third parties. It is determined by the requirements of the: <ul style="list-style-type: none"> <li>NAO's Code of Audit Practice which sets the scope of the audit;</li> <li>The Code of Practice on Local Authority Accounting published by CIPFA/LASSAC which sets the format of the financial statements;</li> <li>HM Treasury in respect of the arrangements for Whole of Government Accounts; and</li> <li>FRC (expected to become ARGA in the year this contract starts) who regulate the work of auditor in the application of International Auditing Standards.</li> </ul> </li> <li>PSAA intends to establish a series of KPIs as part of its contract management arrangements.</li> </ul> |                           | ●           |
| 9.      | <p><b>Delivery risk</b><br/>Risk that the delivery of the audit does not meet planned timescales.</p>   | <ul style="list-style-type: none"> <li>The Accounts &amp; Audit Regulations effectively set a target date for completion of the audit. The past two years (2018/19 and 2019/20) have featured high levels of delayed opinions as a result of a variety of factors. As a result there is a current backlog of outstanding opinions.</li> <li>Audit firms must meet the target dates unless there are good reasons outside their control such as the poor preparation of audit papers or the need for statutory actions.</li> </ul>  | <b>shared risk</b>        |             |

## Risk Allocation Matrix

| Risk id | Risk Category  | Explanatory comments  | Potential risk allocation |             |
|---------|--|---|---------------------------|-------------|
|         |  |   | PSAA                      | Audit Firms |
| 10.     | <p><b>Scope of the Contract</b></p> <p>Audits are not allocated until after contract award.</p> <p>Audits are awarded remote from the audit firm's principal office.</p> | <ul style="list-style-type: none"> <li>Current thinking is that contract lots will be based on work of a specified value of work that is populated with named audits, reflecting a blend of authority types, after completing the tender evaluation process, in consultation with both winning firms and bodies. We are aware that audit firms expressed a preference for bidding for audits on a geographic basis. However, having considered this approach thoroughly we have concluded that it is likely to put at risk the statutory requirement on the appointing person to appoint an independent auditor to every opted-in authority. We intend to introduce a mechanism to enable bidders to reflect geographical preferences in their bids. In addition, when making auditor appointments following contract award (and therefore with audit quality matters already having been assessed), PSAA will have regard to the status of prior years' audits and will be guided by the following principles:               <ul style="list-style-type: none"> <li>ensuring auditor independence;</li> <li>ensuring any minimum guarantees of work are delivered;</li> <li>ensuring a blend of authority types for each audit firm;</li> <li>taking account of a firm's principal locations and geographic preferences (as specified in its tender response);</li> <li>providing continuity of audit firm, where appropriate; and</li> <li>accommodating joint/shared working arrangements where possible.</li> </ul> </li> </ul> |                           | ●           |
| 11.     | <p><b>The audit services fee</b></p> <p>Pricing for Code compliant audits where there is no substantial additional or lesser work or no statutory actions.</p>           | <ul style="list-style-type: none"> <li>The ITT will ask for prices based on the "audited body notional value" for 2021/22. The ABNV is the scale fee for 2021/22 plus actual and estimated recurring fee variations for 2019/20 audits.</li> <li>The winning bidder of each lot will be remunerated for their work to deliver Code compliant audits at a rate equal to the ABNV for that lot multiplied by its bid rate for that lot.</li> <li>Where individual audits currently attract scale fees that do not cover the basic costs of the audit work needed for a Code-compliant audit, PSAA propose to implement a minimum fee level at the start of the next appointing period, for the audit of the 2023/24 accounts. Our independent research indicates a minimum fee level of £31,000 should apply, based on the 2020/21 scope of audit work, to any opted-in body (a police and crime commissioner and a chief constable constitute one body</li> </ul>  |                           | ●           |

## Risk Allocation Matrix

| Risk id | Risk Category  | Explanatory comments   | Potential risk allocation |             |
|---------|--|--|---------------------------|-------------|
|         |  |  | PSAA                      | Audit Firms |
|         | Valuation of substantial additional work.  | <p>for this purpose).</p> <ul style="list-style-type: none"> <li>PSAA cannot anticipate scale fees for the next appointing period at this stage because they will depend on the prices achieved in the procurement and any changes in audit requirements. Where any price increase means that the scale fee for a body does not reach the floor set by the minimum fee, the fee for that body would increase to reach the minimum level. PSAA consults each year on the fee scale and will consult in 2023 on the 2023/24 fee scale.</li> <li>The hourly rates used as part of the determination of the valuation of additional work will continue to be the same for all audited bodies.</li> <li>The winning bidder of each lot will be remunerated for additional work at a rate equal to the current rate card (which will be included in the ITT) multiplied by its bid rate for that lot.</li> <li>The rate card will be updated through the appointing period in line with changes to scale fees that are not related to the level of work – for example, inflation.</li> </ul> |                           |             |
| 12.     | <b>Termination</b><br>Risk that PSAA will terminate (or partially terminate) the contract early i.e. before the end of the initial contract term.                            | <ul style="list-style-type: none"> <li>Contractual provisions describe the conditions under which termination would be invoked, covering: <ul style="list-style-type: none"> <li>Insolvency or change of control</li> <li>Material irremediable or unremedied breach</li> <li>Persistent failure</li> <li>Corruption, bribery, or discrimination</li> <li>Serious security risk</li> <li>Legislative changes.</li> </ul> </li> </ul>   |                           | ●           |
| 13.     | <b>Subcontractor insolvency</b><br>Risk that a subcontractor within the supplier's or subcontractors' supply chain becomes insolvent during the course of the contract term. | <ul style="list-style-type: none"> <li>The audit firm must take this risk as it is responsible for its own supply chains. Failure in the subcontractor supply chain is explicitly excluded from the definition of a 'Force Majeure Event'.</li> </ul>  |                           | ●           |

## Risk Allocation Matrix

| Risk id | Risk Category   | Explanatory comments   | Potential risk allocation |  |
|---------|---|--|---------------------------|--|
|         |   |  | PSAA                      | Audit Firms  |
| 14.     | <b>Industrial action</b><br>Risk of industrial action including by any of the supplier's staff.   | <ul style="list-style-type: none"> <li>The audit firm must take this risk as it is responsible for its own employee relations and it has the ability to control and it is a core element of service delivery. An industrial dispute relating to the audit firm's (or any subcontractor's) personnel is explicitly excluded from the definition of a 'Force Majeure Event'. The audit firm must also take the risk of disruption by other industrial action e.g. the transport network but not industrial action at PSAA or the audited body.</li> </ul>  |                           | <ul style="list-style-type: none"> <li></li> </ul> |
| 15.     | <b>Force majeure</b><br>Risk of unforeseen events outside of the reasonable control of the supplier, that affect the supplier's ability to deliver any aspect of the contract to requirement time, budget, and performance. | <ul style="list-style-type: none"> <li>Neither Party shall be liable to the other Party for any delay in or failure to perform its obligations under the Contract (other than a payment of money) if such delay or failure results from a Force Majeure Event. Each Party shall use all reasonable endeavours to continue to perform its obligations hereunder for the duration of such Force Majeure Event. However, if any such event prevents either Party from performing all of its obligations under the Contract for a period in excess of six (6) Months, either Party may terminate the Contract by notice in writing with immediate effect.</li> </ul> | <b>shared risk</b>        |  |