

Market Engagement

Summary of Responses

July 2020

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Introduction

Background

1. PSAA is an independent company limited by guarantee, incorporated by the Local Government Association. The company was established in August 2014 to fulfil a short-term and time-limited role as a transitional body following the closure of the Audit Commission in March 2015. From April 2015 the company undertook functions delegated by the Secretary of State, including making and managing auditor appointments and setting fees for local public bodies in England, under contracts originally let by the Audit Commission.
2. In July 2016 the Secretary of State appointed PSAA to the role of appointing person for principal local government bodies. The requirements of the appointing person are set out in the Local Audit (Appointing Person) Regulations 2015, issued under provisions of the Local Audit and Accountability Act 2014 (the 2014 Act). The legislation requires the appointing person to discharge its responsibilities for consecutive appointing periods of up to five years. The first appointing period began in April 2018 and covers the audits of the financial years 2018/19 to 2022/23. The appointing person role became fully operational from 1 April 2018.
3. PSAA let five-year audit services contracts to five audit firms in 2017 to enable it to make auditor appointments for the 484 opted-in bodies for the 2018/19 to 2022/23 appointing period, with the option to extend for up to two years. There was a further contract let to a consortium of two firms with no guarantee of appointments – however, that contract is redundant following firm mergers.
4. Implementation of the local audit legislation has occurred in parallel with a period of government and public concern about the role of the auditor. Several national reviews are relevant, including those published in 2018 by Sir John Kingman, and the Competition and Markets Authority, and Sir Donald Brydon in 2019, as is the latest NAO report on governance in the sector, published in January 2019.
5. In 2019 Government also announced an independent review to examine the effectiveness of the local authority financial reporting and audit regime. It is led by Sir Tony Redmond and is expected to report in September 2020.
6. Local audit is a small market in which there are fewer than ten active suppliers, and six currently carrying out local government audits (five of which have a contract with PSAA).
7. Information on PSAA and its Appointing Person scheme is available on the company's website: www.psa.co.uk.
8. In Autumn 2019, PSAA commenced its preparations for the next appointing period, ahead of detailed work on the next opt-in exercise which is scheduled to start in the 2021/22 financial year.
9. PSAA commissioned an independent review of the sustainability of the local government audit market undertaken by an independent consultancy, Touchstone Renard (TR). It draws on the views of audit firms active in the local authority market as well as others that are not. It identified several distinctive challenges in the current local audit market. The full report is available at [PSAA – Future Procurement and Market Supply Options Review](#).

Market Engagement Overview

10. In recognition of the current challenges including those highlighted in the TR report, and to support longer-term sustainability within the local audit market, PSAA is considering whether it might be able to encourage additional, good quality capacity into the market through a further procurement exercise. The aim is, if possible, to seek to relieve some of the existing pressure within the local audit market.
11. PSAA sought the views of all registered audit firms to inform its consideration of the potential value that might be derived by undertaking a further procurement and the potential characteristics of a strategy for a procurement, should it proceed, to complement the existing 2017 audit services contracts. There is no commitment to undertake a further procurement in the current Appointing Period.
12. PSAA were very pleased that all nine firms registered as local auditors submitted a response and engaged with this exercise.
13. Follow-up discussions were offered to all respondents and held with the majority of firms. These were very helpful and enabled clarification of several points.
14. All responses received remain confidential. This summary report of key messages will be shared with key stakeholders including the Redmond Review team, MHCLG and the LGA, and published on the PSAA website.
15. PSAA issued the questionnaire on 1 June 2020 and it was open for 30 days. It was structured with an introduction, background information, purpose and five question sections covering:
 - Coverage of service provision;
 - Procurement Approach – methodology;
 - Procurement Approach – basis for pricing;
 - Tender Evaluation; and
 - Other Comments.
16. Firms were able to choose whether to respond to each individual question. The majority of firms responded fully to all relevant questions.
17. The remainder of this report summarises the key messages contained in the responses by section and outlines the next steps that PSAA intends to take.

Key Messages

Coverage of service provision

18. There is a reasonable degree of actual and potential coverage in the provision of audit services across most English regions although understandably not all regions are equally well served.
19. There are positive signs that it could be possible to attract some additional capacity into the local audit market through a further procurement process under certain conditions, with sufficient lead-in time of around 12-18 months from contracts being awarded.

20. The well-known challenges currently facing the local audit market were frequently referenced as constraints to increasing capacity of service provision. These included:
- the local government audit timetable and how it sits alongside others such as the NHS;
 - increased regulatory pressure and focus on audit quality;
 - the lack of availability of suitably qualified and experienced staff;
 - the barriers for new entrants into the market;
 - the low status of local audit work in comparison to other audit work; and
 - the challenging commercial context and channel choice within the firms.

Procurement Approach – methodology

21. Firms indicated that the methodology used in a further procurement would be a likely influencing factor on their decision to participate. However, there was no clear consensus on a preferred methodology from the given options:
- A procurement (Selection Questionnaire (SQ) and Invitation To Tender (ITT) process) comprising one England-wide Lot, where bidders indicate those regions where they have additional capacity to carry out audits;
 - A procurement (SQ and ITT process) comprising geographical region-based lots where bidders submit only in those where they have additional capacity to carry out audits;
 - Establishment of a Framework Agreement with direct award or subsequent mini-competition for audit packages; and
 - Establishment of a Dynamic Purchasing System (DPS) with subsequent mini competition for audit packages.
22. There was consensus however on the need for the audits within the scope of the procurement to be predefined and named in advance. Factors such as location and the type of authority would be considerations in the firms' assessment of whether to bid for the work. This key message was echoed strongly throughout all responses.
23. Given the likely potential for only a small number of audits to be within the scope of a further procurement, the use of an approach involving mini-competitions for packages of audits did not attract significant levels of concern. However, firms understandably indicated a preference for approaches that would reduce their need to respond to multiple procurement processes.

Procurement Approach – basis for pricing

24. Firms indicated they were open to a range of pricing approaches. However, there was no clear consensus on the basis for pricing from the given options:
- Retain current approach albeit use 2020/21 fees as the baseline
 - Replace the current approach with multiple pricing by type of authority
 - Provide for further price competition under a mini competition as part of a framework agreement
 - Allow for pricing at the time of a tender for one or more audits as part of a DPS

25. There was, however, near consensus against use of the pricing approach adopted for the widescale procurement in 2017, which was based on audited body notional value for a basket of audits. The current scale fees are based on the firms' assessment of the nature, scale and complexity of risk across a portfolio of audits when pricing their tenders in the 2017 audit services procurement. The firms now believe those scale fees do not reflect the nature, scale, complexity and risk of each audit, nor the changes in the audit and accounting requirements that have occurred since 2018. As a result, the contracts are viewed less favourably by the firms in comparison to those for commercial audits.
26. All firms agreed that the basis for pricing should enable suppliers to reflect the individual audit, taking account as much as possible of an organisation's risk and complexity, the quality of its systems and data, and the extent of its accounting expertise.
27. The vast majority of firms were supportive of consideration of an approach which would include a supplementary payment/reimbursement for audits undertaken outside of a radius from a firm's nearest local audit office, in recognition that some areas are "more difficult to resource".

Tender Evaluation

28. All firms agreed that quality should have a greater weighting than price in any tender evaluation. In PSAA's 2017 audit services procurement, quality and price had equal weighting.
29. Firms indicated a weighting range for quality from 60% to 100%, with an average of around 75%, and a corresponding weighting range for price of 40% to 0%. A small number of firms advocated a 100% weighting of quality, suggesting that price should be determined outside of the procurement process.
30. Firms offered several suggestions on ways in which quality could be measured, including the number of Key Audit Partners (KAPs), the outcome of quality reviews, and demonstration of knowledge of the current market issues.
31. Firms suggested that they would be able to evidence their additional capacity, as part of a procurement process, through sharing details of their KAP development pipeline, staffing investment, and training and development plans.
32. There was universal acknowledgement that the number of experienced public sector staff has reduced in recent year and significant difficulties are experienced when undertaking recruitment to public sector audit roles.

Other Comments

33. The most often cited factors that would be most likely to influence firms' decision on whether to participate in a further procurement within the current Appointing Period were:-
 - the level of change in fees and in the rate card for fee variations;
 - the ability to quote a fee for each audit;
 - the length of time available for the audit, a later deadline would greatly mitigate the capacity problems currently affecting the audit market;
 - the outcome of the Redmond Review and any subsequent government response;

- the audit portfolio size / mix;
- the level of improvement in authority finance functions and their preparedness and responsiveness to audit;
- changes to improve the process for agreeing fee variations;
- the weighting of scores for quality and price; and
- internal firm capacity.

Conclusions and Next Steps

34. The market engagement exercise reaffirmed the current challenges facing the world of local audit. It also highlighted that there are some subtle differences in the firms' perspectives on the challenges and correspondingly they are adopting different response strategies.
35. Importantly, it has identified that there is the potential to attract some additional capacity into the local audit market subject to a lead-in period of around 12-18 months from contract award. However, access to this capacity would be dependent on certain circumstances, not all of which are within PSAA's gift.
36. It is clear that a further procurement will not solve all of the supply challenges currently facing the local audit market, but there is the potential to relieve some of the pressure and support longer-term market sustainability.
37. It is worth noting that PSAA is currently reviewing its fee variations process and, should a further procurement be taken forward, will carefully consider the feedback provided by firms when developing its procurement strategy.
38. PSAA is committed to doing all it can to respond proactively to a very challenging environment. We believe that the opportunity to attract additional capacity is worth pursuing and will continue to explore the potential for a further procurement over the next two to three months, seeking views from other stakeholders where appropriate to do so.

Afterword

39. PSAA would like to thank all the firms who responded to the market engagement exercise. Their views have been both insightful and valuable in informing our considerations of the potential benefit of a future procurement exercise.