

Report of:	Director of Finance (S151 Officer)
Submitted to:	Corporate Affairs and Audit Committee
Date:	16 February 2023
Title:	Appointment of External Auditors 2023/24 to 2027/28
Report for:	Information
Status:	Public
Strategic priority:	All
Key decision:	Not applicable
Why:	Report is for information only
Urgent:	No
Why:	

Executive summary

In February 2022, the Council decided to 'opt-in' to the national selection scheme for external audit contracts operated by Public Sector Audit Appointments (PSAA). The current arrangement with Ernst & Young (EY) expires at the end of the 2022/23 financial year and a new contract needs to be in place by 1 April 2023.

PSAA have now made their audit appointments for the new five-year period covering the financial years, 2023/24 to 2027/28. The report set out how the market for this type of service has changed since the 2017 awards, the timetable, processes, and main outcomes from the procurement exercise undertaken.

Final appointments have now been made by PSAA, with Mazars being allocated to Middlesbrough. This is in line with the other local authorities in the Tees Valley area.

The current auditors, EY, still have three sets of accounts to sign off covering 2020/21 - 2022/23, plus value for money assessments for these years. There will be an overlap for a period between the two auditors once Mazars start to work with the Council and until the work required to be done by EY is complete.

Purpose

1. To update the Committee on the allocation of an external auditor for the Council for the financial years 2023/24 to 2027/28. This follows our participation in a national selection scheme undertaken by Public Sector Audit Appointments over the summer of 2022. This is relevant given the Committee's remit in relation to receiving and considering reports & conclusions reached by the auditor each financial year.

Background and relevant information

2. The Local Audit and Accountability Act 2014 requires each Council to appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding year. The local auditor is commonly known as an external auditor.
3. On 8 December 2021, it was highlighted to Members that the current auditor appointment arrangements (the 'National Scheme') covering the period up to and including the audit of the 2022/23 accounts was about to expire. The Council had previously in 2017 opted into the 'appointing person' national scheme established by PSAA for the period covering the accounts from 2018/19 to 2022/23. The auditor appointed for the current contract is Ernst & Young LLP.
4. The report also highlighted that there were several choices available to the Council on how to procure external audit services for the new five-year period. Following discussion, the Committee endorsed participating again in the national scheme. 98% of local councils had participated in the scheme in 2017 given the benefits of the economies of scale that could be achieved by PSAA, rather than the Council undertaking its own procurement exercise. It was expected that take up this time round of the central contracts would be similarly high.
5. The participation in the National Scheme was approved by full Council on 23 February 2022 and their invitation was accepted in early March 2022. The timescale for the procurement by PSAA with audit firms was Spring – Summer 2022, with initial appointments to be allocated during the Autumn. This would be followed by a consultation period and then final appointments to be published by 31 December.
6. As Members will be aware, the external auditors work covers the audit of the annual statement of accounts, the value for money assessment for the Council, and the separate audit of the Teesside Pension Fund which is administered by Middlesbrough. They also have statutory reporting & intervention powers, as well as receiving objections and questions on accounting and governance matters from members of the public and other interested stakeholders. The appointment is a significant undertaking given the scope of the work involved, the current financial landscape for local authorities at present, the five-year contract term and some of the specific local issues at the Council.

Change in the Market from 2017

7. As mentioned in the Dec 2021 report to the Committee, much has changed in the local audit market since audit contracts were last awarded in 2017. At that time the audit market was relatively stable, there had been few changes in audit requirements, and local audit fees had been reducing over a long period.

8. However, during 2018 a series of financial crises and failures in the private sector led to questioning about the role of auditors and the focus and value of their work. This contributed to an urgent drive from the Financial Reporting Council to deliver rapid and measurable increases in audit quality. This has created a major pressure for audit firms within local government to ensure full compliance with regulatory requirements and expectations in every audit they undertake.
9. By the time firms were conducting 2018/19 local audits during 2019, the measures they were putting in place to respond to a more focused regulator were clearly visible. To deliver the necessary improvements in audit quality, there was a requirement for teams to undertake additional work to gain deeper levels of assurance. However, additional work requires more time, posing a threat to the ability to complete all their audits by the target date for publication of audited accounts. These are the major reasons why external audits at the Council have taken significantly longer over the last 2-3 years. There is also the additional issue of increased audit fees.

Summary of PSAA Procurement Outcomes

10. The national scheme auditor appointments procurement exercise was undertaken during the summer and as expected given the marketplace, several issues were encountered. These are summarised below:
 - The PSAA managed to secure enough supply, but it was extremely challenging
 - It took several procurement rounds to get to a final list of approved audit firms
 - Different procurement mechanisms were needed to stimulate this supply
 - There is no spare capacity in the local government local audit market beyond what has been agreed as part of this process
 - There was minimal competition which is disappointing
 - Successful bids are at a significantly higher rate with the total fees likely to be higher by circa 150% comparing 2022/23 to 2023/24
 - There has been a strong reaction to the potential cost increases from the local government sector, with central government being asked to allocate additional funding similar to that received after the Redmond Review.
11. The table below shows the share of the local audit market for local government after the procurement exercise, and the movement at firm level between 2022 and 2017.

Audit Firm	Share of new contracts	Existing Contract Share
Grant Thornton	36.0%	40%
Mazars	22.5%	18%
Ernst & Young	20.0%	30%
KPMG	14.0%	0%
Bishop Fleming	3.75%	0%
Azets Audit Services	3.25%	0%
Deloitte	0.00%	6%
BDO	0.00%	6%

12. The main points to note from the above table are as follows:

- Six of the ten registered firms were successful
- Three firms did not bid, including two current suppliers
- There are two new suppliers (Azets and Bishop Fleming)
- KPMG has returned to the market following not bidding for the work in 2017
- The EY reduction is a pre-determined move to reduce the level of local authority work from current levels
- The top two suppliers have a 58.5% market share down from 70%.

13. The allocation of auditors to specific local authority appointments though is a complex process and takes into the following factors:

- Auditor independence (most important factor)
- Continuity (and longevity) of the current appointment
- Status of any previous year's audits outstanding
- Any joint/shared working arrangements
- Contractual requirements
- Any views/concerns from audited bodies and audit firms.

14. As part of the acknowledgement from PSAA when opting-in to the national scheme, we were asked about any preferences and issues that should be considered during the selection process for auditors. One theme that has been discussed previously with the other Tees Valley authorities is about a single/common auditor for the whole of the area to ensure consistency in both approach and accounting/professional judgements.

15. As part of the 2017 process, three authorities (Stockton, Hartlepool, Redcar & Cleveland) were allocated to Mazars and two authorities (Middlesbrough and Darlington) were allocated Ernst & Young. For 2022, it was agreed between the Councils that we would express a desire to have commonality in our individual responses to PSAA. There are many inter-connected and overlapping issues between this group of councils and it was felt that this single approach with one auditor would be helpful in taking specific issues forward in the future.

Allocation of an Auditor for Middlesbrough Council

16. Towards the end of October, we received notification that the Council had been provisionally allocated **Mazars LLP** as their external auditor from 1 April 2023. This would also apply to the Teesside Pension Fund and be for the next five years.

17. The notification outlined the key elements of the selection process and some minor changes to the contracts currently in place. If there were any comments or objections to the proposed appointment, then these should be made to the PSAA during November. Final appointments would then be confirmed by 31 December in line with statutory requirements.

18. Following discussion with the other local authorities in the area, it was established that Mazars had been allocated to all five local authorities and that the comments made had been considered in the selection process. As a result of this, no comments were made to PSAA and the appointment was confirmed at the end of December.

19. Although the contract with Mazars starts from the 1 April 2023, the existing contract with EY still has some time to run. We are in the final stages of the audit sign-off for 2020/21, almost 15 months behind the statutory deadline. EY are currently undertaking the main fieldwork phase for the 2021/22 audit with a likely timeline being late 2023 for a potential sign off these accounts. The closure and preparation of the accounts for 2022/23 will be between April and June this year, with a possible sign off of these accounts (after audit) in mid to late 2024.
20. In addition to this, there is continuing work with EY around the Council's governance qualification from 2020/21 and on-going issues within Children's Services. It is likely that the current auditors will be with the Council for a further 1-2 years before this work is complete. The Director of Finance will co-ordinate the remaining work with EY and reports will continue to be produced as updates to the Committee in the normal way.
21. As yet, there has been no contact between the Council's senior finance staff and Mazars. Although the contract from PSAA starts from 1 April 2023, most of their work will be around the financial year-end starting from March 2024. There will though be planning work for them to do based on the budget setting process for 2023/24 and sharing of information and updates with EY on continuing work. The Committee will be kept up to date with communications between Council officers and Mazars and their senior staff will be introduced to Members in due course.

What decision(s) are being recommended?

That the Corporate Affairs and Audit Committee:

- Note the appointment of Mazars LLP as the Council's external auditors from 1st April 2023 to 31st March 2028.
- Note that there are still three set of accounts (2020/21, 2021/22 and 2022/23) still be finalised/audited by EY and that there will be a transitional overlap between the two auditors whilst this work is completed.

Rationale for the recommended decision(s)

22. The report is for information so there are no decisions to approve.

Other potential decision(s) and why these have not been recommended

23. Not applicable for this report.

Impact(s) of the recommended decision(s)

24. As mentioned above, there is no decision for the Committee to make in respect of the above report. The appointment of the auditors is a statutory one made by PSAA on the Council's behalf. Members need to note that there will be a transitional period where they will need to work with both sets of firms.

Legal

25. Section 7 of the Local Audit and Accountability Act 2014 requires a relevant Council to appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding year.
26. Section 8 of the above act governs the procedure for the auditor's appointment. Under this the Council has chosen PSAA to be their 'appointing person'.
27. The Local Audit and Accountability Act 2014 and the Accounts and Audit Regulations 2015 set out the parameters for the relationship between the local authority, their external auditors, and the basis of this work.

Strategic priorities and risks

28. The work of external auditor covers all of the strategic priorities of the Council as the financial statements and the value for money assessment cover all aspects of the Council's work.
29. The external auditor will take a view on both the financial and non-financial risks taken by the Council and this will feed into their annual audit results reporting to the Committee.

Human Rights, Equality and Data Protection

30. There are no issues in these areas as part of this report.

Financial

31. Existing base external audit fee levels will increase significantly when the current contracts end. PSAA estimate this to be more than 150% of the current fee for the new audit allocations. It is also clear that the scope of the audit has increased with regulatory changes over the last few years, requiring more audit work.
32. Whether this will have an impact on the Council's budget for audit fees is difficult to say. The current base fee from EY is £106k but given the additional work on the financial statements, governance qualification and children's services, it is expected to be around £400k for 2020/21. Whether the contract with Mazars will increase the cost to the Council is dependant on the additional work that is needed to obtain an audit opinion.

Actions to be taken to implement the recommended decision(s)

Action	Responsible Officer	Deadline
No specific decision but the key action will be to manage the on-going audits with EY and the transitional period with Mazars	Director of Finance/Head of Finance & Investments	Ongoing until the 2022/23 audit is complete.

Appendices

There are no appendices to this report.

Background papers

Body	Report title	Date
Corporate Affairs and Audit Committee	Appointment of External Auditors 2023/24 to 2027/28	8 th December 2021
Council	Appointment of External Auditors 2023/24 to 2027/28	27 th February 2022

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