



PUBLIC SECTOR AUDIT APPOINTMENTS: MARKET ENGAGEMENT FOR 2023/24 – 2027/28 APPOINTING PERIOD

Issued 08 July 2021

ICAEW welcomes the opportunity to respond to Public Sector Audit Appointments (PSAA)'s market engagement survey on the procurement strategy for local authority auditors for the 2023/24 - 2027/28 appointing period. More details can be found on PSAA's website [here](#).

ICAEW broadly supports PSAA's aims and objectives proposed for the procurement:

- We welcome PSAA's attempts to promote market sustainability by encouraging new entrants.
- Capacity is a major issue as only six firms currently undertake local authority audits and two firms carry out 70% of audits. This issue could become more acute with new requirements for PIE audits impacting the wider capacity of firms.
- All participants in the local audit market, including ICAEW and PSAA, should redouble efforts to promote the importance of timely, high quality local audits.
- PSAA's proposal to attach a weighting of 80% for quality aspects of tender responses reflects increasing expectations of auditors.
- PSAA are right to be concerned about delays to audit opinions but the only way PSAA can address this is by supporting efforts to expand capacity in the market.

More transparency is required about the procurement to provide certainty to firms:

- PSAA should allocate opted-in bodies to lots prior to the procurement to increase transparency and allow firms to properly calculate fees that take in to account all factors including location and audit risk rather than just body size.
- We advocate dividing lots based on geographic regions as this will encourage bids from firms based in limited geographical areas.
- PSAA should publish the key performance indicators it intends to use to assess the quality of bids.

Many of the proposed measures in the prospectus may be difficult to operate in practice:

- ICAEW welcomes innovative measures to expand the market but joint audit arrangements may be difficult in practice. PSAA need to engage with experienced suppliers to understand what incentives they need to support market opening measures.
- It is important the market is allowed to set fees at a realistic level and PSAA should avoid seeking to artificially force down or cap prices to mitigate the risk of market exit.
- It may be difficult to distinguish between experienced suppliers on quality. PSAA need to take steps to avoid rewarding box ticking or making price the most important distinguishing factor between bids.

ICAEW

Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
T +44 (0)20 7920 8100 F +44 (0)20 7920 0547 icaew.com

The Institute of Chartered Accountants in England and Wales (ICAEW) incorporated by Royal Charter (RC000246)
Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 157,800 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

ICAEW's Public Sector team supports greater transparency and accountability in the public sector and provides policy recommendations to ensure taxpayers' money is managed wisely. Our Better Government Series is a series of thought leadership, policy insights, toolkits and best practice special reports on public sector financial management issues. The ICAEW's Public Sector Community comprises members working in and with government at all levels to deliver public priorities and strong public finances.

INTRODUCTION

1. We are responding to the Public Sector Audit Appointments (PSAA)'s market engagement survey on the procurement strategy for local authority auditors for the 2023/24 - 2027/28 appointing period.
2. The Secretary of State for Housing, Communities and Local Government has confirmed PSAA as the sole national appointing body for the audits in England from 2023/24, under the provisions of the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2015. PSAA has a statutory responsibility to appoint an auditor to every principal local government and police bodies that have opted into its scheme.
3. PSAA has produced a market prospectus to introduce the procurement to invite views from eligible bodies and a market engagement exercise primarily for auditors. ICAEW has responded to the market engagement exercise to express our views to assist PSAA in designing the procurement strategy.
4. Our comments are solely intended to support the PSAA with designing an effective procurement strategy.
5. ICAEW is a body whose mission is to promote the public interest and whose members are accountable under a code of ethics. In that context we seek to and want to play a constructive role in supporting PSAA's role as the appointing person for principal local government and police bodies for audits to ensure a robust and sustainable local audit market. We would be willing to provide further information about any of the views expressed in our response.
6. We share PSAA's primary aim in the procurement of securing "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".

© ICAEW 2021

All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

For more information, please contact: representations@icaew.com

QUESTION RESPONSES

Question 1: What are your views on the draft aim and objectives for the procurement proposed by PSAA?

7. ICAEW broadly supports the draft aim and objectives. The procurement should be as transparent as possible to ensure that firms know what they are bidding for and can set realistic prices to conduct work to a sufficient quality. We agree that the framework needs to be flexible enough to adapt to changing requirements.
8. We share PSAA's concerns about the timeliness of audit opinions but do not think it is realistic for this to be addressed by the procurement. The best way to address this from the auditor side is through increasing capacity in the market by encouraging new entrants.
9. It is important that all participants in the market, including PSAA and ICAEW, emphasise the importance of good quality, timely local audits and a sustainable local audit market. Audit is essential for accountability, transparency and ensuring good quality financial management by identifying issues that can be addressed. As local authorities face significant financial pressure and undertake more commercial transactions, this external assurance is more important than ever. Audited local authority accounts are a key tool for elected councillors to scrutinise the financial situation and risks the council is taking, for residents to understand how their taxpayers' money is spent and for central government departments to monitor local authorities.

Question 2: What are your views on the procurement route proposed by PSAA?

10. ICAEW is concerned about the lack of transparency in the proposed procurement route. We believe that PSAA should allocate opted-in bodies to lots in advance of the procurement so that audit firms know what they are bidding for. This will allow them to set more realistic prices that reflect the actual cost of the work they are bidding for, reflecting factors like geographic location and audit risk that play a greater role in impacting the cost of the audit than the size of the body.
11. We welcome PSAA's desire to encourage new entrants but believe that transparency about the bodies in each lot is essential to facilitate this. This allows new entrants to research the audits and assess whether they have the expertise and capacity to conduct such audits. In particular, smaller audit firms may be reluctant to bid for larger councils that could put the whole firm within the scope of the Financial Reporting Council's review regime but they cannot ascertain whether this will be the case without knowing what is in each lot.
12. We support the proposal to accept bids from firms that are currently proceeding through the local audit registration process. However, any award to such firms should be conditional on ICAEW, as the RSB, approving their registration and the procurement must not prejudice ICAEW's approval process. PSAA should ensure it has contingency plans in place for the re-awarding of lots should any of these firms be successful in the procurement.
13. There is no realistic alternative to a restricted procedure open to registered firms for the majority of lots. For the lots targeted at new entrants, this should be open to any potential entrant that partners with an experienced supplier.

Question 3: What are your views on the proposal to establish a dynamic purchasing system (DPS), in parallel to the main procurement, with a very simple and straightforward entry process?

14. The DPS idea is a positive development and more realistic than the previous approach of a contract with nil guaranteed value. Firms need certainty and the realistic chance of work to invest in public sector teams and the necessary training.
15. Our preference is for the DPS to be open at any time throughout the contract so that new firms entering the market can join once they are registered to conduct local audits. Smaller firms may welcome the opportunity to audit one or two clients rather than a substantial

number that would be required by a lot. Should the DPS encourage new entrants, it could be a useful tool for PSAA to reappoint auditors if existing firms are struggling with capacity.

Question 4: What are your views on the contract duration proposed by PSAA, in particular the proposal to make the option to extend the contract subject to mutual agreement?

16. Five-year contract lengths risk locking firms out the market especially at a time when MHCLG are considering proposals, such as a review of KAP criteria, that may make it easier for potential firms to enter the market.
17. Audit requirements may also change significantly in a five-year period which could substantially alter fees and capacity, especially with the proposed new requirements for auditors of Public Interest Entities arising from the BEIS consultation. PSAA should explain how they intend to react to this should there be unexpected changes to auditing standards.
18. However, we do not see a realistic alternative to five-year contracts as both auditors and audited bodies need certainty. Shorter length contracts may discourage investment in public sector teams and discourage firms bidding for work.
19. We support the proposal to make the option to extend the contract subject to mutual agreement. This will allow suppliers to decline to undertake work that they do not have capacity to do and ensure that they maintain quality.

Question 5: What are your views on PSAA's preference to enter into new long term contracts with suppliers rather than extending the existing contracts?

20. We support the proposals for new long term contracts. There are only 5 firms currently with contracts and it is desirable to allow the market to expand. The requirements on local auditors and the audit risks in light of Covid-19, Brexit and changes to accounting rules have changed substantially since the current contracts were awarded. It is unsustainable to simply extend the contracts as fees are too low and there are too many fee variations each year.
21. While it is possible that extending the contracts for two years buys time for new firms to enter the market, it more likely simply delays a capacity problem. If there are not enough bidders to fill the lots this time, it seems unlikely that the situation will have improved in two years time especially as the capacity of large firms may be stretched by the proposed new requirements for Public Interest Entity audits in the BEIS consultation "Restoring trust in audit and corporate governance".

Question 6: What are your views on our current thinking about the circumstances in which, and the basis on which, PSAA might, if necessary, make a decision to extend one or more of the current contracts?

22. This should only be done as a last resort and in consultation with the firms. If firms do not bid for lots, it is unlikely they have capacity to take on work through a contract extension. If there are not bids of sufficient quality at acceptable prices in this procurement round, it is difficult to see why this will have changed in two years time. The larger firms will likely be working on implementing the proposed new requirements for Public Interest Entity audits, which will have a significant impact on capacity.
23. If an insufficient number of firms bid for work, PSAA should consider re-opening the procurement process rather than extending contracts.

Question 7: What are your views on our initial thinking about lot structure and the suggestion that bidders identify the maximum annual portfolio value of work they could undertake?

24. As noted in the answer to question 2, ICAEW believes it is important that firms know which audits are in each lot in advance of the bidding process. This allows them to calculate accurate prices that reflect the costs and audit risks of the audit. Firms will be able to conduct research on the lots to ascertain key information, such as whether the lot contains any local

authorities classified as public interest entity, to establish whether they have the capacity and capability to conduct such work.

25. It is very unusual for a national procurement not to specify the content of lots. When the NAO contracts out audits, it specifies which audits make up each lot and thus provides valuable information to potential bidders, reducing uncertainty and independence risks. We understand PSAA's concerns that this means there is an increased risk that some lots, with unattractive audits, may not attract bidders but we counter that in the private sector, there has never been a case where a company has not been able to find an auditor. The same is true of NHS bodies where there is not an equivalent national appointing body to PSAA.
26. The justifications for the abolition of the Audit Commission and the introduction of the Local Audit and Accountability Act 2014 were to open the market, increase competition and drive improvements in audit quality as a result but this is held back by creating this unique situation where firms do not know for which audits they are bidding. This favours larger firms that can absorb the shock if the lot contains more risky or complex audits than they anticipated.
27. Our view is that the lots should be divided by geographic areas. The current approach of allocating bodies spread across the country to each lot favours firms with national public sector teams rather than those located in certain areas and may add unnecessary travel and accommodation costs.
28. ICAEW supports the increased number of lots because this facilitates more entrants to the market. We understand the justification for bidders to identify the maximum annual portfolio value of work but it is important that the market is not dominated by very few suppliers to reduce the risk of market collapse. The current structure of two firms holding 70% of the market is unsustainable as should one of them exit, other firms in the market may not have the capacity to pick up the work. We urge PSAA to consider capping the total amount of audits allocated to a single firm.

Question 8: We are considering the inclusion of one or more lots targeted at attracting additional capacity into the market, most likely involving some form of joint working/consortia arrangements between more experienced suppliers and new entrants or less experienced suppliers. What are your views on this proposal which would be a new feature of the procurement strategy compared to the current contracts?

29. ICAEW welcomes PSAA's proactive efforts to encourage new entrants to the market. There is a widespread view, which ICAEW shares, that increasing capacity in the market through new entrants is desirable to address delays to audit opinions, strengthening audit quality and establishing contingent capacity should an experienced supplier exit the market.
30. We support PSAA engaging in innovative measures to encourage new entrants such as these but have concerns whether the proposals will work in practice. We would be very interested in the responses to this question from the market engagement exercise. It is unclear what incentives there are for more experienced suppliers to agree to these sorts of engagements especially as they carry substantial complexity and potential regulatory risk. The government's wider audit reform proposals for private companies already pose significant risks for these firms and they may conclude that they cannot engage in untested initiatives such as these at this time.
31. From our recent survey, there is not a large number of firms looking to enter the market and potential entrants may consider that a joint audit arrangement carries more risk. However, should the proposals gain support in the market engagement exercise, ICAEW would welcome them. We believe that any increase in audit fees that arises from these arrangements is a worthwhile investment if it expands the market.

Question 9: What could PSAA or other players in the local audit system do to support potential suppliers to enter the market?

32. The proposals in the prospectus show PSAA is trying to encourage new entrants but its ability is limited by its narrow remit. ICAEW is urging a review of the KAP eligibility criteria

and supporting proposals for a centre of excellence to provide an alternative route to KAP status as we feel this is a significant barrier to entry as it is difficult for firms not already in the market to enter.

33. Local authority audits carry a relatively high inherent risk compared to similar sized companies due to under resourced local authority finance teams, weak financial positions, fraud risks from grant expenditure, increasingly complex transactions and investments and the rising possibility of the council being forced to issue a section 114 notice. They also carry high reputational risks as there is significant interest in council finances when things go wrong and this can lead to greater scrutiny of the auditor's role. Local councils need to put greater investment into their finance teams as a way of trying to reduce these risks and to make local authority audits more attractive to new entrants. Other bodies such as MHCLG and LGA also have a responsibility to champion the important role of the finance teams.
34. Investment is also needed by MHCLG to support councils, particularly in more remote areas, to pay fees that make the local audit market attractive. Too much of the focus since the abolition of the Audit Commission has been about saving money, which is not conducive to improving quality. MHCLG should also provide funding for the proposed centre of excellence and even consider, subject to competition and other applicable laws, sponsoring potential new entrants to send their staff to the centre.
35. We endorse recommendations in the Redmond Review around accounts streamlining and preventing frivolous accounts objections. Local authority accounts are unnecessarily complex and often run to over 40 notes compared to an average of around 20 notes for central government bodies. This creates unnecessary work for auditors and can be off-putting to potential new entrants.
36. Firms could look at a model similar to the NAO's contracted out audits. The NAO Director acts as engagement partner under ISA 220 (supported by an NAO manager) but the audit work is carried out by the firm and the firm partner provides a shadow certificate. In the case of a disagreement, the two parties attempt to resolve these but the NAO's view takes precedence. The NAO could do more to actively promote this model for local audits.
37. BEIS should amend the Companies Act legislation to allow for public sector audit work experience to be included against the number of days required for UK statutory audit. This would make local audit more attractive for trainees and less experienced staff.
38. We therefore welcome PSAA's approval to apply a greater weighting to quality compared to price but we question the need for PSAA to set acceptable price ranges. Local authority financial statements need to be actively reviewed and critiqued by an external body in order to drive better quality and improve understandability.

Question 10: What are your views on the proposed lot composition and potential way in which bidders might reflect geographical preferences within their bids which has been developed in response to previous market feedback? Your views on other potential ways to address this would also be welcomed.

39. As noted in response to previous questions, ICAEW believes that each lot should be based on a regional area so that firms can bid for work only in the areas where they have public sector audit teams. This should reduce unnecessary travel costs and mean that firms can set realistic prices.
40. We understand that some regions may be less popular than others and command higher prices due to travel and accommodation costs but believe it is better that prices reflect the cost of performing the audit and consider this more effective than PSAA's proposal of providing additional fees to firms conducting audits in areas that are contrary to their preferences.

Question 11: To help further inform our thinking on lot sizes, it would be very helpful if you would provide an indication of both the minimum and maximum annual portfolio value of work that you would be likely to consider bidding for, assuming all other terms were

acceptable. When stating the minimum and maximum values, please use the basis of the current aggregate contract values which for 2021/22 audits is c. £29m per annum (excluding fee variations) for c.470 audits.

41. N/A - ICAEW does not perform audit work.

Question 12: Please use the box below to add any further commentary to support your responses, or to comment more broadly on matters related to Lot structure, composition, and size that PSAA should consider.

42. We have no further comments.

Question 13: What are your views on the proposed basis for pricing and the potential options outlined as ways through which to seek to reduce bidder uncertainty which have been developed in response to previous market feedback? Your views on other potential ways in which to seek to reduce bidder uncertainty would be welcomed.

43. It is difficult for firms to set realistic prices without knowing what they are bidding for. It is not possible to set accurate prices based on the value of a body because this does not take in to account key factors such as inherent audit risk, the quality of the finance team or geographic location. As we have stated in response to previous questions, PSAA should specify the bodies contained within each lot in advance of the procurement and firms are then much better informed to set realistic prices. We would encourage PSAA to ask firms to provide a breakdown of the price they are proposing per audit to ensure that audit costs incurred by each body reflect the actual price of completing the audit and there is no cross-subsidisation. We appreciate this may increase the costs for bodies in remote locations but believe this could be subsidised by additional support for MHCLG.

44. We question the need for PSAA to set acceptable price ranges as it is important that market forces set the prices at a level that is necessary to ensure sufficient quality. PSAA should not artificially force down or cap the price, as this risks firms leaving the market. Firms that quote higher prices will already get lower scores in the price evaluation so we do not feel it is necessary to add a further barrier.

45. Auditors incur significant additional work and cost when councils set up new entities or engage in new business. There needs to be a transparent mechanism for how these are reflected in increased audit fees. Currently, the fee variation approach is too slow and burdensome meaning that auditors often absorb these costs.

Question 14: What are your views on this indicative timetable for the procurement?

46. ICAEW welcomes the fact that PSAA has announced proposals for lots designed to encourage new entrants early in the process as this will allow potential entrants to have conversations with experienced suppliers.

47. The timetable contains a long lead time, which means that even if firms manage to get themselves registered by April 2023, they are not going to be in a position to bid for work.

Question 15: Our initial thinking is to attach a weighting of 80% for the quality aspects of tender responses, including social value. This reflects the views and expectations of the market as expressed to PSAA over the past 15 months. It is in line with the approach taken in recent similar public audit procurements. What are your views on this proposal which has been developed in response to previous market feedback?

48. ICAEW supports this proposal as we feel there needs to be a greater focus on quality rather than reducing prices. Expectations are increasing and it is important that firms meet these expectations.

49. Given that the firms bidding for the larger lots are likely to be experienced suppliers, it may be very difficult to distinguish them on quality. PSAA need to take steps to ensure that despite the 80:20 split, price does not become the most significant distinguishing factor. We

welcome PSAA's plans to publish the quality KPIs but some aspects of audit quality are subjective in nature (such as quality assurance procedures) and it may be difficult to measure them by numerical KPIs. Extreme caution should be applied before applying criteria such as "KAP time" allocated to engagements as this could be more reflective of the quantity and significance of issues the audit team have identified rather than the quality of the oversight. PSAA should take care to avoid designing criteria that result in rewarding box ticking rather than auditor judgement.

50. Of the criteria listed in the prospectus, we do not understand how PSAA propose to differentiate on "audit approach" given all firms have to go through a rigorous registration process with ICAEW as RSB and are required to complete ISA-compliant audits. PSAA does not have the expertise, and nor should it, to assess the quality of firm-wide procedures in major accountancy firms.
51. The "client relationship management" criteria should include criteria that assesses how the audit firms intend to add value to the clients and the sector more widely. For example, audit firms should be encouraged to provide training on the audit and accounts to audit committee members, public accounting guidance for local authorities and contribute to working groups. They should not however be encouraged to provide services outside the scope of an external audit such as providing advice on future budgets or making difficult accounting judgements on behalf of clients as these could be breaches of ethical standards.
52. Different criteria are required for potential new entrants who may find it harder to demonstrate quality. Firms should not be penalised for a lack of prior experience in conducting local authority audit work or submitting tenders.

Question 16: We are considering the inclusion of one or more lots targeted at attracting additional capacity into the market. We are mindful that such lots may require the application of different evaluation criteria to recognise the specific circumstances and deliver the desired outcome. What are your views on the desirability of creating lots with this particular focus and the need for a different evaluation approach to such lots? Are there specific factors that we should consider when developing the evaluation criteria?

53. ICAEW welcomes this proposal and using different criteria to assess these bids. Despite our reservations about the attractiveness of these arrangements in practice, we are not aware of any other realistic proposals for encouraging new firms to enter the market.
54. The criteria should favour arrangements that give the new entrant sufficient responsibility. For example, arrangements involving senior staff from the new entrant acting in key roles (manager, director) or genuine joint audit arrangements should be prioritised ahead of those that only have minor measures like secondments of junior staff. Bids need to set out which audit software will be used and whether the new entrant will have access to training from the larger firms.
55. The evaluation criteria should consider how well the engagement supports the new entrant in achieving registration in its own right and being able to bid for work independently in future. New entrants should demonstrate clear plans for how they will provide the necessary training to their staff performing public sector audits for the first time.

Question 17: What action would you recommend PSAA and/or other market participants take in order to avoid delayed opinions becoming a feature of the next appointing period?

56. ICAEW shares PSAA's concerns about delayed opinions. We submitted our views to the PAC enquiry on the timeliness of auditor reporting, where we stated that we believe that "many of the delays experienced are symptomatic of wider problems in the local audit market and in the preparation of local authority finance statements that need to be addressed." We highlighted insufficient investment in finance teams, the lack of expertise in audit committees and the capacities of audit firms as key factors in the delay.
57. We believe there is limited action that PSAA can take to tackle the delays beyond designing the procurement to increase capacity in the market. It needs to remind audited bodies of their

responsibilities to provide good quality working papers and draft accounts in order to meet planned timetables. It needs a flexible, quick and transparent approach that allows the firms to pass on costs to audited bodies where the audited bodies fail to provide adequate working papers or its accounts contain a high level of error.

58. MHCLG should consider maintaining a public register of published audited local authority accounts along similar lines to the Charities Commission's register of charities. This should include a single list of the local authorities that have missed the relevant deadlines. MHCLG should actively monitor the list and, once a certain length of time has passed from the deadline, should actively seek to understand the reasons for the delay and assess whether it can take any action to support the local authority or auditor.

Question 18: Please use the box below to share with PSAA those key factors that are most likely to influence your firm's decision on whether to participate in a procurement for audit services for opted-in bodies undertaken in the early part of 2022.

59. This question is not applicable to ICAEW.

Question 19: Finally, please use the box below to identify any other issues that you wish to bring to our attention as we progress the development of our procurement strategy. We are also happy to receive comments on other aspects of the local audit system, including any barriers to entry or other constraining factors, which you feel have the potential to inhibit the development of a more stable and sustainable system.

60. The audit fee for each body should reflect the price charged by the audit firm and there should not be any cross-subsidisation between bodies. MHCLG should subsidise local authorities and other bodies that are forced to pay higher fees due to their remote location. We therefore oppose the proposal to set a minimum audit fee for smaller bodies as this should be set by the audit firm. If audit firms are not required to provide a price breakdown, PSAA should calculate it based on market comparators without using artificial caps or ceilings.
61. We suggest that PSAA consider providing a mechanism for firms and audited bodies to agree fee increases on a local level with escalation to PSAA in the case of a disagreement. This should cover additional risks to the audit that have arisen not as a result of weaknesses in financial information at the local authority but as a result of new ventures such as establishing a new company or investing in a new type of commercial transaction.
62. Where fee increases are necessary due to poor quality financial records, working papers or draft accounts, the fee variation process may remain the fairest and most effective way to deal with this. PSAA should however provide data to MHCLG on where these occur and work with MHCLG, CIPFA and the audited body to assess how these issues can be resolved in the future.
63. PSAA and other participants in the local authority audit market need to carefully consider the implications of the government's proposals to introduce "managed shared audits" for large private sector companies. This could be a more attractive option for challenger firms looking to expand into a new sector than entering the local authority audit market given the high inherent risks in local audit that we have discussed in previous answers.