



**TO: Audit & Governance Committee**

**FROM: Head of Audit & Assurance**

**DATE: 20 September 2016**

**PORTFOLIOS AFFECTED: All**

**WARDS AFFECTED: All**

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<b>TITLE OF REPORT</b>	<b>Arrangements for the Appointment of External Auditors</b>
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**1. PURPOSE**

To inform Members of the arrangements for appointing External Auditors from the audit year 2018/19 following the closure of the Audit Commission and the end of the transitional arrangements at the conclusion of the 2017/18 audits.

The Council will need to consider the options available and put new arrangements in place to make a first appointment by 31 December 2017 for the audit year 2018/19.

**2. RECOMMENDATIONS**

The Committee is asked to consider and comment upon the three options for the provision of external audit services from 2018/19, namely:

- Establishing a stand-alone Auditor Panel to make the appointment on behalf of the Council (Option 1);
- Commencing work on exploring the establishment of local joint procurement arrangements with neighbouring authorities (Option 2); or
- Supporting Public Sector Audit Appointments (PSAA) as the national Sector Led Body (SLB) by indicating our intention to “opt-in” to their collective procurement approach (Option 3).

**3. BACKGROUND**

In 2011 the Department for Communities & Local Government (DCLG) announced plans for transferring the audit work of the Audit Commission’s in-house audit practice to the private sector and thereafter to allow local audited bodies to appoint their own external auditors. The Audit Commission subsequently awarded new external audit contracts for 5 years.

The Local Audit and Accountability Act 2014 (the Act) at Section 7 states that a “relevant authority must appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding financial year.” Current external audit contracts have been extended for 12 months. Therefore the appointment of an auditor for the Council must be completed by 31 December 2017 for the audit year 2018/19.

The Council's current external auditor is Grant Thornton, this appointment having been made under at a contract let by the Audit Commission. Over recent years we have benefited from reduction in fees in the order of 50% compared with historic levels. This has been the result of a combination of factors including new contracts negotiated nationally with the firms of accountants and savings from closure of the Audit Commission. The Council's current external audit fees are £102,839 per annum.

The Local Government Association (LGA) is strongly supportive of the SLB approach as it believes this offers best value to Councils by reducing set-up costs and having the potential to negotiate lowest fees and has been investigating the feasibility of establishing a SLB to deliver economic and efficient external arrangements across all authorities.

As the greatest economies of scale would come from the maximum number of councils acting collectively in opting-in to a SLB, in order to maximise their negotiating position the LGA recently contacted Councils to test their opinion as to whether they would be potentially interested in the SLB option. Over 200 authorities have already signalled their positive interest in a national scheme.

#### **4. RATIONALE**

The Audit & Governance Committee, in its role of providing an independent and high-level focus on the audit, assurance and reporting arrangements that underpin good governance and financial standards, is required to oversee external audit, helping to ensure efficient and effective assurance arrangements are in place.

The work of external audit forms a key element of the Council's overall system of internal control. Effective external audit arrangements promote best practice and improvements in the management of risks and value for money. A key requirement for the Audit & Governance Committee, in order for the Committee to meet its Terms of Reference, is to assess the adequacy of the external audit provision.

#### **5. KEY ISSUES AND RISKS**

Following the closure of the Audit Commission transitional arrangements were established for the appointment of external auditors and the setting of audit fees for all local government and NHS bodies in England. The contracts are currently managed by PSAA, the transitional body set up by the LGA, with delegated authority from the Secretary of State Communities and Local Government. When the current transitional arrangements come to an end on 31 March 2018 the Council will be able to move to local appointment of the external auditor.

The scope of the audit will still be specified nationally. The National Audit Office (NAO) is responsible for writing the Code of Audit Practice which all firms appointed to carry out the Council's audit must follow. Not all accounting firms will be eligible to compete for the work, they will need to demonstrate that they have the required skills and experience and be registered with a Registered Supervising Body approved by the Financial Reporting Council. The registration process has not yet commenced and so the number of firms is not known but it

is reasonable to expect that the list of eligible firms may include the top 10 or 12 firms in the country, including our current auditor. It is unlikely that small local independent firms will meet the eligibility criteria.

There is no immediate risk to the Council. However early consideration by the Council of its preferred approach will enable detailed planning to take place so as to achieve successful transition to the new arrangement in a timely and efficient manner.

There are three broad options open to the Council under the Act:

**Option 1: To make a stand-alone appointment**

In order to make a stand-alone appointment the Council will need to set up an Auditor Panel. The members of the panel must be wholly or a majority independent members as defined by the Act. Independent members for this purpose are independent appointees, this excludes current and former elected members (or officers) and their close families and friends. A new independent Auditor Panel established by the Council would be responsible for selecting the external auditor.

*Advantages/benefit*

Setting up an auditor panel allows the Council to take maximum advantage of the new local appointment regime and have local input to the decision.

*Disadvantages/risks*

Recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract is estimated by the LGA to cost in the order of £15,000 plus on going expenses and allowances. The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts. The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by elected members.

**Option 2: Set up a Joint Auditor Panel/local joint procurement arrangements**

The Act enables the Council to join with other authorities to establish a joint auditor panel. Again this will need to be constituted of wholly or a majority of independent appointees (members). Further legal advice will be required on the exact constitution of such a panel having regard to the obligations of each Council under the Act, and the Council will need to liaise with other local authorities to assess the appetite for such an arrangement.

*Advantages/benefits*

The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities. There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.

*Disadvantages/risks*

The decision making body will be further removed from local input, with potentially no input from elected members where a wholly independent auditor

panel is used or possibly only one elected member representing each Council, depending on the constitution agreed with the other bodies involved.

The choice of auditor could be complicated where individual Councils have independence issues. An independence issue occurs where the auditor has recently or is currently carrying out work such as consultancy or advisory work for the Council. Where this occurs some auditors may be prevented from being appointed by the terms of their professional standards. There is a risk that if the joint auditor panel choose a firm that is conflicted for this Council then the Council may still need to make a separate appointment with all the attendant costs and loss of economies possible through joint procurement.

### **Option 3: Opt-in to a sector led body**

In response to the consultation on the new arrangement the LGA successfully lobbied for Councils to be able to 'opt-in' to a SLB appointed by the Secretary of State under the Act. An SLB would have the ability to negotiate contracts with the firms nationally, maximising the opportunities for the most economic and efficient approach to procurement of external audit on behalf of the whole sector. Public Sector Audit Appointments (PSAA) have been approved by DCLG to be a sector led body for principal authorities. If the Council is considering choosing PSAA then it is likely that the formal invitation will need to be accepted in the autumn.

#### *Advantages/benefits*

The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities. By offering large contract values the firms would be able to offer better rates and lower fees than are likely to result from local negotiation. Any conflicts at individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.

The appointment process would not be ceded to locally appointed independent members. Instead a separate body set up to act in the collective interests of the 'opt-in' authorities. The LGA in the process of setting up such a body utilising the knowledge and experience acquired through the setting up of the transitional arrangements.

#### *Disadvantages/risks*

Individual elected members will have less opportunity for direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups. In order for the SLB to be viable and to be placed in the strongest possible negotiating position the SLB will need Councils to indicate their intention to opt-in before final contract prices are known.

To keep all the Council's options open at this stage the Director of Finance & IT has notified the LGA of the Council's potential support for the SLB approach on a non-binding basis.

The LGA issued a draft prospectus in July setting out a broad outline of the SLB offering, inviting comments. The timetable for issuing formal invitations has not yet been finalised. However for planning purposes full Council approval will be

required for this decision under Regulation 19 of the Regulation 19 of the Local Audit (Appointing Person) Regulations 2015. The LGA anticipate that PSAA will issue such invitations in October 2016 with an expected window for acceptance remaining open until December 2016 or early 2017

**6. POLICY IMPLICATIONS**

To meet its terms of reference the Audit & Governance Committee needs to assess the adequacy of the external audit provision.

**7. FINANCIAL IMPLICATIONS**

The cost of establishing a local or joint Auditor Panel outlined in options 1 and 2 above will need to be estimated, this will include the cost of recruiting independent appointees (members), servicing the Panel, running a bidding and tender evaluation process, letting a contract and paying members fees and allowances.

Option 3 - opting-in to a national SLB provides maximum opportunity to limit the extent of any increases by entering in to a large scale collective procurement arrangement and would remove the costs of establishing an Auditor Panel. The LGA believes that audit fees achieved through block contracts will be lower than the costs that individual authorities will be able to negotiate. In addition, by using the SLB councils will avoid having to do their own procurement and the legal requirement to set up a panel of independent members.

**8. LEGAL IMPLICATIONS**

This report fulfils the statutory requirements placed upon by the Council by the Local Audit and Accountability Act 2014.

Section 7 of the Local Audit and Accountability Act 2014 (the Act) requires a relevant authority to appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding year. Section 8 governs the procedure for appointment including that the authority must consult and take account of the advice of its auditor panel on the selection and appointment of a local auditor. Section 8 provides that where a relevant authority is a local authority operating executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the authority under those arrangements.

Section 12 makes provision for the failure to appoint a local auditor: the authority must immediately inform the Secretary of State, who may direct the authority to appoint the auditor named in the direction or appoint a local auditor on behalf of the authority.

Section 17 gives the Secretary of State the power to make regulations in relation to an 'appointing person' specified by the Secretary of State. This power has been exercised in the Local Audit (Appointing Person) Regulations 2015 (SI 192) and this gives the Secretary of State the ability to enable a SLB to become the appointing person.

**9. RESOURCE IMPLICATIONS**

The resource implications attached to the options will be subject to further assessment and reported to Committee.

**10. EQUALITY IMPLICATIONS & HEALTH IMPLICATIONS**

There are no equality or health implications arising as a result of this report.

**11. CONSULTATIONS**

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Date: 9 September 2016

Background Papers: New Arrangements for External Audit, noted at the Audit Committee meeting of 20 September 2011.

DCLG: Government response to the Future of Local Audit

DCLG: Future of local public audit – consultation: summary of responses Local Audit and Accountability Act 2014 (the Act).