



REPORT OF:	DIRECTOR OF FINANCE & IT
TO:	COUNCIL FORUM
ON:	26 JANUARY 2017

SUBJECT: ARRANGEMENTS FOR THE APPOINTMENT OF EXTERNAL AUDITORS

1. PURPOSE OF THE REPORT

- 1.1 To advise the Council of the new arrangements for the appointment of the Council's external auditors for the audit year 2018/19.
- 1.2 If the Council wishes to utilise the national scheme for appointing auditors in the future, which will be operated by Public Sector Audit Appointments (PSAA), it must accept the PSAA's invitation to do so by early March 2017. The paper seeks approval for this and in doing so, approval for the PSAA to appoint the Council's external auditor for the 2018/19 accounts and beyond; this recommendation was endorsed by the Audit & Governance Committee at their meeting on 10th January 2017.

2 Options

- 2.1 Under the Local Audit & Accountability Act 2014 there are three options regarding the arrangements to appoint our own external auditors. These are:
- Opting into a sector led body arrangement that may be established as the appointing person under the Act;
 - Establishing the Council's own independent auditor panel to make a stand-alone appointment; or
 - Join with other authorities to establish a joint auditor panel to make the appointment.
- These options are discussed in the sections below.

3. RECOMMENDATIONS

- 3.1 The Council accepts the invitation from PSAA to 'opt in' to the sector led option for the appointment of external auditors for five financial years commencing 1 April 2018.

4. BACKGROUND

- 4.1 The Council's external auditors are currently working under a contract originally let by the Audit Commission. The contract was novated to PSAA following the closure of the Audit Commission.
- 4.2 In 2011 the Department for Communities and Local Government (CLG) consulted with Authorities on options for the future of external audit following the announcement of plans to disband the Audit Commission. The Chair of the Audit Committee responded following

consideration of the proposals at the Committee's meeting in June 2011. The results of the consultation and the timetable for change were presented to the September 2011 meeting.

- 4.3 The Local Audit and Accountability Act 2014 (the Act) received Royal Assent on 30 January 2014. The Act brought to a close the Audit Commission and established transitional arrangements for the appointment of external auditors and the setting of audit fees for all local government and NHS bodies in England. On 5 October 2015 the Secretary of State CLG determined that the transitional arrangements for local government bodies would be extended by one year to also include the audit of the accounts for 2017/18.
- 4.4 The Act also set out the arrangements for the appointment of auditors for subsequent years, with the opportunity for authorities to make their own decisions about how and by whom their auditors are appointed. Regulations made under the Act allow authorities to 'opt in' for their auditor to be appointed by an 'appointing person'.
- 4.5 Secondary legislation was required to give effect to many of the provisions of the Act. In June 2014 the CLG consulted with organisations on the draft regulations affected by the changes (Government response to the Future of Local Audit). This included the specification of the Collective Procurement body for larger authorities and the Audit and Accounts Regulations. The results, 'Future of Local Government - Consultation on secondary legislation: summary of responses and the Government Response', were published in December 2014.
- 4.6 In July 2016 PSAA were specified by the Secretary of State as an 'appointing person' under Regulation 3 of the Local Audit (Appointing Person) Regulations 2015. The appointing person is sometimes referred to as the 'sector led body' and PSAA has wide support across local government. PSAA was originally established to operate the transitional arrangements following the closure of the Audit Commission under powers delegated by the Secretary of State. PSAA is an independent, not-for-profit company limited by guarantee and established by the LGA
- 4.7 PSAA is inviting the Council to opt in, along with all other authorities, so that it can enter into a number of contracts with appropriately qualified audit firms and appoint a suitable firm to be the Council auditor.
- 4.8 The principal benefits from such an approach are as follows:
 - PSAA will ensure the appointment of a suitably qualified and registered auditor and expects to be able to manage the appointments to allow for appropriate groupings and clusters of audits where bodies work together;
 - PSAA will monitor contract delivery and ensure compliance with contractual, audit quality and independence requirements;
 - Any auditor conflicts at individual authorities would be managed by PSAA who would have a number of contracted firms to call upon;
 - It is expected that the large-scale contracts procured through PSAA will bring economies of scale and attract keener prices from the market than a smaller scale competition;
 - The overall procurement costs would be lower than an individual smaller scale local procurement;
 - The overhead costs for managing the contracts will be minimised through a smaller number of large contracts across the sector;
 - There will be no need for the Council to establish alternative appointment processes locally, including the need to set up and manage an 'auditor panel';

- The new regime provides both the perception and reality of independent auditor appointment through a collective approach; and
- A sustainable market for audit provision in the sector will be easier to ensure for the future.

- 4.9 At present, apart from two district Councils, all the other Council's in Lancashire are planning to use the sector led approach.
- 4.10 The Council's current external auditor is Grant Thornton, this appointment having been made under at a contract let by the Audit Commission. Following closure of the Audit Commission the contract was novated to PSAA, and since this date PSAA has demonstrated its capability in terms of auditor appointment, contract management, and monitoring audit quality. Over recent years authorities have benefited from a reduction in fees in the order of 55% compared with fees in 2012. This has been the result of a combination of factors including new contracts negotiated nationally with the audit firms and savings from closure of the Audit Commission. The Council current external audit fees are £102,839 per annum.
- 4.11 The proposed fees for the subsequent years cannot be known until the procurement process has been completed, as the costs will depend on proposals from the audit firms.
- 4.12 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 audit 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.
- 4.13 Currently, there are only nine providers that are eligible to audit local authorities and other relevant bodies; all of these firms have a national presence. This means that a local procurement exercise, as described immediately below, would seek tenders from these same firms, subject to the need to manage any local independence issues. Local firms could not be invited to bid.

5 Other Options

- 5.1 If the Council does not opt in it will need to establish an independent auditor panel. In order to make a stand-alone appointment the auditor panel would need to be set up by the Council itself. The members of the panel must be wholly or a majority of 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. This means that elected members will not have a majority input into assessing bids or in choosing which audit firm to award the contract. The LGA have estimated that recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract will cost an authority in the order of £15,000 plus on going expenses and allowances.
- 5.2 Alternatively 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). The costs of setting up the panel, running the bidding exercise and negotiating the contract would 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. However further legal advice would be required on the exact constitution of such a panel having regard to the obligations of each Council

under the Act and the Council would need to liaise with other local authorities to assess the appetite for such an arrangement. 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.

- 5.3 Neither of these options is recommended. Both these options would be more resource-intensive processes to implement and without the bulk buying power of the sector led procurement, would be likely to result in a more costly service. It would also be more difficult to manage quality and independence requirements through a local appointment process.

6 RATIONALE

- 6.1 Regulation 19 of the Local Audit (Appointing Person) Regulations 2015 requires that a decision to opt in must be made by a meeting of the full Council. The Council then needs to formally respond to PSAA's invitation in the form specified by PSAA by early March 2017.
- 6.2 PSAA will commence the formal procurement process after this date. It expects to award contracts in summer 2017 and consult with authorities on the appointment of auditors so that it can make an appointment by the statutory deadline of December 2017.
- 6.3 In 2016 the Council notified the LGA of its potential support for the sector led body approach. PSAA has now formally invited the Council to opt in to the sector led scheme. Details of the invitation are provided at Appendix 1 to this report. In summary the national opt-in scheme provides the following:
- The appointment of a suitably qualified audit firm for each of the five financial years commencing 1 April 2018;
 - Appointing the same auditor to other opted in bodies that are involved in formal collaboration or joint working initiatives to the extent this is possible with other constraints;
 - Managing the procurement process to ensure both quality and price criteria are satisfied. PSAA will seek views from the sector to help inform its detailed procurement strategy;
 - Ensuring suitable independence of the auditors from the bodies they audit and managing any potential conflicts as they arise;
 - Minimising the scheme management costs and returning any surpluses to scheme members;
 - Consulting with authorities on auditor appointments, giving the Council the opportunity to influence which auditor is appointed;
 - Consulting with authorities on the scale of audit fees and ensuring these reflect scale, complexity and audit risk; and
 - Ongoing contract and performance management of the contracts once these have been let.
- 6.4 A sector-wide procurement conducted by PSAA will produce better outcomes and will be less burdensome for the Council than any procurement undertaken locally. More specifically:
- The audit costs are likely to be lower than if the Council sought to appoint locally, as national large-scale contracts are expected to drive keener prices from the audit firms;
 - Without the national appointment, the Council would need to establish a separate independent auditor panel, which could be difficult, costly and time-consuming;

- PSAA can ensure the appointed auditor meets and maintains the required quality standards and can manage any potential conflicts of interest much more easily than the Council; and
- Supporting the sector-led body will help to ensure there is a vibrant public audit market for the benefit of the whole sector and this Council going forward into the medium and long term.

7. POLICY IMPLICATIONS

None

8. FINANCIAL IMPLICATIONS

- 8.1 There is a risk irrespective of the route chosen to appoint the external auditor that the current fee levels could increase when the current contracts end in 2018.
- 8.2 Opting-in to a national scheme provides maximum opportunity to ensure fees are as low as possible, whilst ensuring the quality of audit is maintained by entering in to a large scale collective procurement arrangement.
- 8.3 If the national scheme is not used, additional resource will be needed to establish an auditor panel and conduct a procurement exercise. Until a procurement exercise is completed it is not possible to state what, if any, additional budget would be required for audit fees for 2018/19 and beyond.

9. LEGAL IMPLICATIONS

- 9.1 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. Section 8 governs the procedure for appointment including that the Council 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 Council is a local Council operating executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the Council under those arrangements.
- 9.2 Section 12 makes provision for the failure to appoint a local auditor: the Council must immediately inform the Secretary of State, who may direct the Council to appoint the auditor named in the direction or appoint a local auditor on behalf of the Council.
- 9.3 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 Sector Led Body to become the appointing person. In July 2016 the Secretary of State specified PSAA as the appointing person.

10. RESOURCE IMPLICATIONS

None

11. EQUALITY & HEALTH IMPLICATIONS

None

12. CONSULTATIONS

Audit & Governance Committee, Chief Executive and Deputy Chief Executive

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Background Papers: None