



# Agenda Item 7

## Audit and Standards Committee Report

**REPORT OF** Interim Executive Director of Resources

**DATE**  
15<sup>th</sup> Sept 2016

**SUBJECT** Changes to the arrangements for the appointment of External Auditors

**SUMMARY** This report summarises the changes to the arrangements for appointing External Auditors following the closure of the Audit Commission and the end of the transitional arrangements at the conclusion of the 2017/18 audits.

### RECOMMENDATIONS

Resulting from the Local Audit and Accountability Act 2014, Members of the Audit and Standards Committee are asked to note and consider the options for appointing External Auditors from April 2018.

**FINANCIAL IMPLICATIONS  
CLEARED BY**

K Inman

**PARAGRAPHS  
24**

### BACKGROUND PAPERS

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**CATEGORY OF  
REPORT**

Open

## Statutory and Council Policy Checklist

<b>Financial implications</b>
<del>YES</del> /NO      Cleared by: K Inman
<b>Legal implications</b>
<del>YES</del> /NO
<b>Equality of Opportunity implications</b>
<del>YES</del> /NO
<b>Tackling Health Inequalities implications</b>
<del>YES</del> /NO
<b>Human rights implications</b>
<del>YES</del> /NO
<b>Environmental and Sustainability implications</b>
<del>YES</del> /NO
<b>Economic impact</b>
<del>YES</del> /NO
<b>Community safety implications</b>
<del>YES</del> /NO
<b>Human resources implications</b>
<del>YES</del> /NO
<b>Property implications</b>
<del>YES</del> /NO
<b>Area(s) affected</b>
<b>Relevant Scrutiny Committee if decision called in</b>
Not applicable
<b>Is the item a matter which is reserved for approval by the City Council? <del>YES</del>/NO</b>
<b>Press release</b>
<del>YES</del> /NO

## **Purpose of the Report**

1. This report summarises the changes to the arrangements for appointing External Auditors following the closure of the Audit Commission and the end of the transitional arrangements at the conclusion of the 2017/18 audits.
2. The Council will need to consider the options available and put in place new arrangements in time to make a first appointment by 31 December 2017.

## **Recommendations**

3. Resulting from the Local Audit and Accountability Act 2014, Members of the Audit and Standards Committee are asked to note and consider the options for appointing External Auditors from April 2018.
4. Members are requested to consider the options and consider the preferred approach of either:
  - i) 'Opt-in' to a national Sector Led Body set up by the Local Government Association (LGA).
  - ii) Establishing a stand-alone Auditor Panel to make the appointment on behalf of the Council.
  - iii) Commencing work on exploring the establishment of local joint procurement arrangements with neighbouring authorities/public bodies.
5. Note that a formal decision will be required at a later date which will need Full Council approval.

## **Background**

6. The Local Audit and Accountability Act 2014 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 Communities and Local Government (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.
7. The Council's current external auditor is KMPG, this appointment having been made under a contract let by the Audit Commission. Following closure of the Audit Commission the contract is currently managed by Public Sector Audit Appointments Limited (PSAA), the transitional body set up by the LGA with delegated authority from the Secretary of State CLG. The Council's external audit fee for 2016/17 is £187,000.
8. 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 auditor. There are a number of routes by which this can be achieved, each with varying risks and opportunities.

9. Current external audit fees are based on discounted rates offered by the firms in return for substantial market share. When the contracts were last negotiated nationally by the Audit Commission they covered most NHS and local government bodies and so offered maximum economies of scale.
10. 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 as 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, so the number of eligible firms is not known, but it is reasonable to expect that the list 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.

### **Options for local appointment of External Auditors**

11. The Council has until December 2017 to appoint its external auditors. In reality decisions need to be taken with regards to which process is to be followed and implemented in order for the appointment to be made in good time.
12. There are three broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act):

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

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

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

13. **Option 1:** 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. This means that elected members will not have a majority input to assessing bids and choosing which firm of accountants to award a contract for the Council's external audit. The new independent auditor panel established by the Council would be responsible for selecting the auditor.

#### *Advantages/benefit*

- a) 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*

- a) 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.
- b) The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
- c) The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by elected members.

14. **Option 2:** 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 need to liaise with other local authorities/public sector bodies to assess the appetite for such an arrangement.

*Advantages/benefits*

- a) The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
- b) 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*

- a) 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 possible only one elected member representing each council, depending on the constitution agreed with the other bodies involved.
- b) 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 a 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.

15. **Option 3:** PSAA has now been approved by DCLG to be a sector-led body for principal authorities (councils, police and fire bodies). A 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.

*Advantages/benefits*

- a) The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities.
- b) 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.
- c) Any conflicts at individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.
- d) The appointment process would not be made by locally appointed independent members. Instead a separate body, set up to act in the collective interests of the 'opt-in' authorities, would do this.

*Disadvantages/risks*

- a) Individual elected members will have less opportunity for direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.
- b) 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.

**The way forward**

- 16. The Council has until December 2017 to make an appointment. In practical terms the option selected will determine the timescale required for a formal decision.
- 17. The PSAA had already issued a prospectus setting out some of their proposals in the event that they were confirmed as a SLB, and they were seeking responses to their suggested approach. SCC has expressed an interest in opting in to a SLB without prejudice.
- 18. If SCC is considering choosing PSAA then it is likely that the formal invitation needs to be accepted by December 2016. The decision to choose this route must be made by the Full Council.
- 19. If option 1 or 2 is preferred this needs to be agreed by spring 2017 in order that the contract negotiation process can be carried out during 2017.

## **Financial Implications**

20. The cost of establishing a local or joint Auditor Panel outlined in options 1 and 2 above will need to be estimated and included in the Council's budget for 2017/18. 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.
21. Opting-in to a national SLB provides maximum opportunity to limit the extent of any fee increases by entering in to a large scale collective procurement arrangement and would remove the costs of establishing an auditor panel.

## **Conclusion and Future Action**

22. The Council will need to take action to implement new arrangements for the appointment of external auditors from April 2018. Although it is a Council decision, the Audit Committee should consider the options with a view to making a recommendation to Council.
23. The Senior Finance Manager, Internal Audit is consulting with other neighbouring local authorities/public bodies in order to explore the appetite for setting up a joint auditor panel and other options for local joint procurement arrangements.
24. Further reports will be brought to this Committee on the preferred approach for approval from Council.

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