

## **Appointment of External Auditor**

### **Report of the County Treasurer**

Please note that the following recommendation is subject to confirmation by Committee before taking effect.

**Recommendation** : that Members note the process for appointment of future External Auditor arrangements.

#### **1. Background to the issue**

- 1.1. The Local Audit and Accountability Act 2014 abolished the Audit Commission and established transitional arrangements for the appointment of external auditors, together with 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 these transitional arrangements for local government bodies would be extended by one year to also include the audit of the accounts for 2017/18.
- 1.2. The Council's current external auditor is Grant Thornton; this appointment was made by a procurement process led by the Audit Commission. Following the abolition of the Audit Commission the contract is currently managed by Public Sector Audit Appointments Limited (PSAA), the transitional body set up by the Local Government Association with delegated authority from the Secretary of State. Over recent years the external audit fee has halved. This has been the result of a combination of factors including new contracts negotiated nationally with the accountancy firms and savings from the closure of the Audit Commission. The County Council's current external audit fee is £135,000 per annum.
- 1.3. When the current transitional arrangements come to an end on 31<sup>st</sup> March 2018 the County Council will be able to move to the local appointment of an auditor. There are a number of routes by which this can be achieved, each with its own risks and opportunities. Current 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 NHS and local government bodies and offered maximum economies of scale.
- 1.4. 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 will include the top 10 or 12 accountancy firms in the country, including Grant Thornton. It is unlikely that small local independent firms will meet the eligibility criteria.

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

2.1. There are three broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act):

### **2.2. Option 1 - To make a stand-alone appointment**

2.3. In order to make a stand-alone appointment the Council will need to set up an Auditor Panel. This will be in addition to the existing Audit Committee. The members of the Panel must be wholly or have 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. A new independent Auditor Panel established by the Council will be responsible for selecting the auditor. 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.

2.4. The advantage of this approach is that setting up an Auditor Panel allows the County Council to take maximum advantage of the new local appointment regime and have local input to the decision.

2.5. However, the disadvantages are :-

2.6. Recruitment and servicing of the Auditor Panel, and running the procurement exercise is estimated by the LGA to cost in the order of £15,000 plus on going expenses and allowances

2.7. The County Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.

2.8. The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by elected members.

2.9. Experience in other areas has shown that It may be problematic to appoint the required number of independent members.

### **2.10. Option 2 - Set up a Joint Auditor Panel/local joint procurement arrangements**

2.11. 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. 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 County Council would need to liaise with other local authorities to assess the appetite for such an arrangement.

2.12. The advantages of this approach are :-

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

2.14. There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.

2.15. It might prove easier to appoint the required number of independent members via this approach.

2.16. However, the disadvantages are :-

2.17. 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.

2.18. 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.

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

2.20. In response to the consultation on the new arrangement the LGA successfully lobbied for Councils to be able to 'opt-in' to a Sector Led Body (SLB) appointed by the Secretary of State under the Act. 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.

2.21. The advantages are :-

2.22. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities

2.23. By offering large contract values the firms would be expected to offer better rates and lower fees than are likely to result from local negotiation

2.24. Any conflicts of interest at individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.

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

2.26. The disadvantages are :-

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

2.28. 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.

## **3. The way forward**

3.1. The Council have until December 2017 to make an appointment. In practical terms this means one of the options outlined above will need to be agreed as our preferred option by spring 2017 in order that the contract negotiation process can be carried out during the latter part of 2017.

- 3.2. The LGA is working on developing a Sector Led Body (SLB). Greater economies of scale will come from the maximum number of councils acting collectively and opting-in to a SLB. An initial expression of interest in the Sector Led approach has been given by the County Council, however this is not binding and a final decision will be taken when full details of the arrangements are known. It is anticipated that these will become clear before the year end. Public Sector Audit Appointments has recently been specified as sector-led appointing body under the Local Audit (Appointing Person) Regulations 2015.

#### **4. Risk Management**

- 4.1. There is no immediate risk to the County Council, however, early consideration by the Authority 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.
- 4.2. Providing the LGA with a realistic assessment of our likely way forward will enable the LGA to invest in developing appropriate arrangements to support the Council.

#### **5. Legal implications**

- 5.1. 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;
- 5.2. 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.
- 5.3. 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.

#### **6. Financial Implications**

- 6.1. Current external fees levels may increase when the current contracts end in 2018.
- 6.2. 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 and beyond. 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, if the decision is to appoint an Auditor Panel.
- 6.3. 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.

## **7. Conclusion and Next Steps**

- 7.1. The Council will need to take action to implement new arrangements for the appointment of external auditors from April 2018.
- 7.2. From the three options outlined above, Option 3 may be the preferred approach, if the final choice of appointment, from a range of available framework external audit suppliers, rests with the County Council. If such a choice is not available, the County Council could seek to establish a Joint Auditor Panel with local partners and undertake a procurement process, commencing early in 2017.
- 7.3. A further report will be brought to the Audit Committee, once the detail of the Sector Led approach is known. It should be noted that this report is for information only. The Audit Committee will not have any decisions to take in terms of Auditor Panel formation, application of Sector Led Approach or appointment of the External Auditor. The Act indicates that such decisions will be required to be taken by the relevant authority, in this instance the full Council.

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Background Paper                      Date                      File Ref

Nil

There are no equality issues associated with this report.