

## **COUNCIL**

**13 OCTOBER 2016**

### **APPOINTMENT OF EXTERNAL AUDITOR**

Report from/Author: Phil Watts, Chief Finance Officer

#### **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.

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.

#### **1. Budget and Policy Framework**

- 1.1. The decision on how the external auditor should be appointed is a matter for Full Council, though Audit Committee will have an advisory role.

#### **2. Background**

- 2.1. 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 for 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.
- 2.2. The Council's current external auditor is BDO, 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. Over recent years the Council has benefited from a 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 the closure of the Audit Commission. The Council's proposed external audit fees for 2016-17 are £142,451 for the core audit, housing benefit subsidy claim £9,188, teachers' pension return £4,200, and pooled housing receipts £3,200, based on the 2016-17 fee letter.
- 2.3. 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. 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.

- 2.4. 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 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.

### **3. Options for local appointment of External Auditor**

- 3.1. 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**

- 3.2. In order to make a stand-alone appointment the Council would 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 family and friends. This means that elected Members would not have a majority input into assessing bids and recommending which firm of accountants to award a contract for the Council's external audit. The role of an Auditor Panel would be to advise the Council on:

- The selection and appointment of a local auditor
- The maintenance of an independent relationship with the local auditor appointed to audit its account
- Any proposal by the Council to enter into a liability limitation agreement
- Whether to adopt a policy on purchasing non-audit services from the local auditor
- The outcome of any investigation of an auditor's resignation from office, if this occurs, or on any proposal to remove a local auditor from office.

#### *Advantages/benefit*

- 3.3. Setting up an auditor panel allows the Council to ensure that there is local input into the decision.

#### *Disadvantages/risks*

- 3.4. 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.

- 3.5. The Council would need to consider the EU requirements of the procurement, which could increase the timescale of the exercise and the level of resources required.
- 3.6. The Council would not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
- 3.7. The assessment of bids and decision on awarding contracts would be taken by independent appointees and not solely by elected Members.

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

- 3.8. The Act enables the Council to join with other authorities to establish a joint auditor panel. Again this would need to be constituted of wholly or a majority of independent appointees (Members). 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.

#### *Advantages/benefits*

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

#### *Disadvantages/risks*

- 3.11. The decision making body would 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.
- 3.12. 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**

- 3.13. 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. In July 2016, the Secretary of State for Communities and Local Government specified Public Sector Audit Appointments (PSAA) as an appointing person under regulation 3 of the Local Audit (Appointing Person) Regulations 2015. This means that PSAA can make auditor appointments for audits of the accounts from 2018-19 of authorities that

choose to opt into its arrangements. Before an authority opts into these arrangements it must formally accept an invitation to become an opted in authority. This decision would be a matter for Full Council. PSAA will 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.

- 3.14. If the Council was to decide on this option then there is no requirement to establish an Auditor Panel.

*Advantages/benefits*

- 3.15. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities.
- 3.16. 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.
- 3.17. Any conflicts at individual authorities would be managed by PSAA who would have a number of contracted firms to call upon.
- 3.18. The appointment process would not be ceded to locally appointed independent Members. Instead PSAA would act in the collective interests of the 'opt-in' authorities.

*Disadvantages/risks*

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

**4. Advice and analysis**

- 4.1. The Local Government Association have asked local authorities to submit non-binding expressions of interest in a sector-led body, and the Chief Finance Officer has indicated that the Council may be interested in this approach.
- 4.2. Discussion with the Kent Finance Officers Association found that all Kent local authorities had expressed an interest to the LGA and as such there is no local appetite to set up a Joint Auditor Panel/local joint procurement arrangements as set out at Option 2 above.
- 4.3. A standalone appointment, as set out at Option 1 above is considered to present financial risks as the council may suffer higher audit fees as it would not benefit from the bulk purchasing discounts offered by Option 3. Option 1 would require significant investment in the recruitment, training, servicing and allowances to maintain an Auditor Panel.

- 4.4. As such officers would recommend the council's interests would be best served by opting in to a Sector Led Body, as set out in Option 3.
- 4.5. The Council have until December 2017 to make an appointment. In practical terms this means one of the options outlined in this report will need to be in place by spring 2017 in order that the contract negotiation process can be carried out during 2017.

## **5. Audit Committee - 29 September 2016**

- 5.1 Members considered a report which summarised 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.
- 5.2 Members supported Option 3 in the report (Opt-in to a sector led body) and also noted that Option 2 (Set up a Joint Auditor Panel) was effectively no longer a realistic option given that most other councils in the area had confirmed that they also supported the opt-in to a sector led body approach.
- 5.3 Given the shared audit service with Gravesham Borough Council, a Member commented that it would make sense for both councils to have the same external auditor and queried whether this was something the Council could request. Officers advised that the Council could make that request but it was likely that, in any event, the sector led body which would be responsible for appointing the auditor would more than likely appoint an auditor to cover a specific geographical area and therefore Medway and Gravesham Councils would probably (unlike now) have the same auditor under the new arrangements

## **6. Risk management**

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

## **7. Financial implications**

- 7.1. Current external fees levels are likely to increase when the current contracts end in 2018.
- 7.2. The cost of establishing a local or joint Auditor Panel outlined in options 1 and 2 above would need to be estimated and included in the Council's budget for 2016-17 and 2017-18. This would 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.
- 7.3. 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.

## **8. Legal implications**

- 8.1. 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.
- 8.2. 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.
- 8.3. 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.
- 8.4. Section 19 of the Local Audit (Appointing Person) Regulations 2015 specifies that the decision to accept an invitation to become an opted in authority is a matter for Full Council.

## **9. Recommendation**

- 9.1 The Council is recommended to agree to Option 3 (Opt-in to a sector led body) in relation to the appointment of the External Auditor.

### **Lead officer contact**

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### **Appendices**

None

### **Background papers**

None