

Report to Audit and Risk Committee 13 February 2017

Appointment of External Auditor

Submitted by: Head of Finance

Portfolio: Finance IT and Customer

Wards Affected: All

Purpose

To enable the Audit and Risk Committee to recommend the arrangements for the appointment of external auditors for the Council, with effect from the accounts for the financial year 2018/19.

Recommendations

- a) **That Full Council is recommended to opt into the national scheme for auditor appointments (Public Sector Audit Appointments).**

Reason

The current arrangements for external audit will end following the audit of the 2017/18 accounts and will in future be governed by the Local Audit and Accountability Act 2014, which provides for a number of different processes for the appointment of the auditor.

1. Background

- 1.1 The council's current external auditors, Grant Thornton, were appointed by the Audit Commission. This was a transitional arrangement to enable continuity following the abolition of the Commission until formal arrangements were put in place by legislation.
- 1.2 The Local Audit and Accountability Act 2014 (the Act) now sets out the legal framework for the appointment of auditors and for Councils to monitor their work.
- 1.3 The current audit arrangements will end after the audit of the 2017/18 accounts. As a result, the Council will need to appoint an auditor for the 2018/19 accounts and after.
- 1.4 There are a number of appointment process options set out in the Act, which need to be considered and the most suitable selected.

2. Issues

- 2.1 The appointment of the auditor and the process to be used in making the appointment is a decision that must be taken by Full Council. However, the Audit and Risk Committee will clearly have a view with regard to the procedure for the appointment. This report is intended to enable the Committee to consider and recommend its preferred option for the appointment process to Full Council.
- 2.2 The scope of the audit will be specified nationally by the National Audit Office which is responsible for writing the National Code of Audit Practice, which all firms appointed to carry out local authority audits must adhere to. Not all accounting firms will be

eligible to compete for the work, they will need to demonstrate that they have the necessary 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 yet 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 the Council's current auditor. It is unlikely that small local firms will meet the eligibility criteria.

- 2.3 The Council has until December 2017 to make the appointment. In practical terms this means that one of the options outlined at paragraph 2.4 must be in place by early 2017 in order that the contract negotiation process can be carried out in time.
- 2.4 There are three options permitted by the Act for the process to be followed to appoint the auditor. These all involve the Council itself making the appointment and are:
- 1) The Council can carry out its own process and make a stand alone appointment;
 - 2) The Council can act jointly with other authorities to appoint an auditor for all of them;
 - 3) The appointment can be made using a national "Sector-Led Body".
- 2.5 The Act provides for local authorities to set up auditor panels. These will oversee the appointment of auditors and monitor the relationship with the auditor once appointed. This part of the Act takes effect once the Secretary of State has made regulations giving local authorities the power to set up panels. He has not yet done so. When the regulations have been made a report will be brought to the Committee outlining their functions and how they are to be set up. The appointment process must be carried out using an auditor panel in respect of options 1) and 2) above.
- 2.6 The Local Government Association (LGA) has set up a body entitled "Public Sector Auditor Appointments" (PSAA). This body has been approved by the Secretary of State as a "Sector-Led Body". Currently it is the only such approved body and is likely to remain so. All local authorities have been invited to opt into the PSAA scheme, with a final deadline for doing so of 9 March 2017. Authorities that choose not to opt-in by this deadline may opt in later but not until after 1 April 2018, which is too late to make an auditor appointment for the audit of the 2018/19 accounts. PSAA will draw up a specification for local authority audit and invite bids from firms for the work.
- 2.7 PSAA intends to carry out a procurement exercise and to let contracts for five years and will divide the country into two large contract areas nationally; each one divided into three or four contract lots per area, depending on how many authorities opt in. Within each area they intend to appoint a number of firms, which will help them to manage independence issues. Following completion of this process each opted-in authority will be allocated an auditor. Each opted-in authority will be asked about any conflicts of interest which might arise with regard to specific firms (for example as a result of consultancy work already carried out by the firm for the Council) and about any other local factors considered relevant. PSAA will endeavour to appoint the same auditors to opted-in bodies that are involved in formal collaboration or joint working initiatives, if those bodies consider that this will enhance efficiency or value for money.
- 2.8 PSAA will pool scheme costs (i.e. the costs of the contracts negotiated with the various firms plus PSAA's administrative costs) and charge fees to audited bodies in accordance with a fair scale of fees which has regard to size, complexity and audit

risk. Pooling will mean that everyone in the scheme will benefit from the most competitive prices. Fees will reflect the number of scheme participants - the greater the level of participation, the better the value represented by the fees. Fees will be determined by the prices achieved in the procurement process that PSAA will need to undertake during the early part of 2017. Contracts are likely to be awarded at the end of June 2017 and at this point the overall cost and therefore the level of fees required will be clear. PSAA expect to consult on the proposed scale of fees in autumn 2017 and to publish the fees applicable for 2018/19 in March 2018.

2.9 PSAA state that they will:

- a) Only contract with approved firms that have a proven track record in undertaking public audit work
- b) Include obligations in relation to maintaining and continuously improving quality in their contract terms and in the quality criteria in their tender evaluation
- c) Ensure that firms maintain the appropriate registration and will liaise closely with the Recognised Supervisory Body and the Financial Reporting Council to ensure any quality concerns are detected at an early stage
- d) Take a close interest in our feedback and in the rigour and effectiveness of firms' own quality assurance arrangements

2.10 There are advantages and disadvantages associated with all three options. These are outlined below.

2.11 **Option 1** - Council carries out the process itself and appoints the auditor solely as its auditor.

Advantages:

- The process is entirely under the Council's control and members have direct input into the process

Disadvantages:

- The Council will not be able to take advantage of lower fees that may be available using Options 2 or 3.
- There will be administrative costs and probably considerable time spent in organising and attending panel meetings and carrying out the procurement process in-house.
- Panels will include independent appointees so the decision will not be taken solely by elected members
- The number of firms attracted to bid may be appreciably less than under the other options

2.12 **Option 2** - Council carries out a joint procurement process with other authorities

Advantages:

- Costs of the procurement process will be shared across a number of authorities
- More firms may be attracted to bid than under Option 1
- Consequently the fees payable may be less than under Option 1

Disadvantages:

- It is not known whether any other authorities would be interested in participating in a joint process with the Borough Council
- The fees payable, although possibly less than under Option 1 will most likely be higher than achievable under Option 3.
- There will still be administrative costs and probably considerable time spent in organising and attending panel meetings (there will still be a need for a joint panel) and carrying out the procurement process.
- Panels will include members from all participants and independent appointees so the decision will be further removed from local input.
- There will be the possibility of disagreement between the participating authorities.
- The choice of auditor could be complicated if individual authorities have independence issues.

2.13 **Option 3** - Council uses PSAA to make the appointment

Advantages:

- There will be no direct administrative costs incurred by the Council and virtually no time will be spent carrying out the procurement exercise. PSAA's costs will be shared over all of the opted-in authorities so provided there are sufficient the amount attributed to individual authorities will be insignificant.
- Fees are likely to be less than under either of the other options owing to the larger contract sizes attracting competitive rates
- Any conflicts involving individual authorities will be managed by PSAA who will have a number of contracted firms to call upon
- PSAA is a body set up by the LGA and should, therefore, be run in the interests of local government

Disadvantages:

- Borough Council Members will have little or no involvement in the process.

2.14 It is recommended that Option 3, to use PSAA to carry out the process, is adopted. This would appear to be the most cost effective way of making the appointment and would involve far less expenditure of administrative time. It is also believed, that there are likely to be worthwhile savings in terms of the audit fees payable because PSAA will be in a good position to secure competitive prices owing to the size of contracts offered. Because PSAA is an LGA body this also provides the necessary element of assurance that the Council's interests will be borne in mind and safeguarded. There are already a considerable number of authorities which have expressed an interest in participating in the PSAA scheme and it is likely that the majority of authorities will chose this option. The decision will need to be taken by Full Council on 22 February 2017 in order to meet the deadline for opting into the PSAA scheme.

3. Legal and Statutory Implications

3.1. The Council must have its accounts audited by an independent external auditor. The requirements and framework for appointing auditors are contained in the Local Audit and Accountability Act 2014.

4. Financial and Resource Implications

4.1. Although the fees payable under the PSAA arrangements are not yet known it is unlikely that they will be significantly higher than the present fees. If this procurement option is not pursued, the likely fees are harder to predict and any significant increase

would need to be included in the Medium Term Financial Strategy as a new pressure in 2019/20.

5. Major Risks

- 5.1. It is possible that there may be insufficient interest in bidding for the work from audit firms, resulting in competitive fee levels not being obtained. This is unlikely if PSAA is used for the procurement, owing to the contract sizes on offer.
- 5.2. If either of the other options are used there may be insufficient interest attracted to enable sufficient choice of potential contractor to be available. If no bids were received or they were of insufficient quality, there is a danger that the Council might run out of time to procure an auditor for the 2018/19 accounts.

6. Background Papers

- 6.1. Local Government and Accountability Act 2014.
- 6.2. Invitation from Public Sector Audit Appointments to become an opted in authority (letter dated 27 October 2016).