

Eden District Council

Accounts and Governance Committee

30 June 2016

Council

14 July 2016

Sector-led Appointment of External Auditors

Report of the Director of Finance

1. Purpose of Report

- 1.1 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.
- 1.2 The Council needs to consider the options available and put in place new arrangements in time to make a first appointment by 31 December 2017.

2. Recommendation

Accounts and Governance Committee

Recommend to Council that:

- the Council opts in principle, in to the Local Government Association supported sector-led procurement of local authority external auditors from 31 December 2017.
- the Director of Finance is given delegated powers in consultation with the Chairman of the Accounts and Governance Committee to commit to the sector-led procurement.

Council

Agree the recommendation from the Accounts and Governance Committee

3. Background

- 3.1 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 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.

- 3.2 The Council's current external auditor is Grant Thornton, 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 local government has benefited from 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 closure of the Audit Commission.
- 3.3 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.
- 3.4 It is a legal requirement that a local authority must have an external auditor. A local authority's external auditor has three main roles. Firstly, it audits the annual accounts. As part of this the auditor gives an opinion on a council's Value for Money arrangements and also ensures that the Annual Governance Statement is consistent with their understanding of the council. Secondly, the auditor certifies grant claims when required by the grant giving body: at the moment the only such grant claim for Eden is the Housing Benefits subsidy claim. Thirdly, the external auditor considers issues raised by local residents and, if warranted, takes action. These issues normally relate to items in the accounts and questions on legality.

The scope of the audit is specified nationally by the National Audit Office (NAO). This is set out in the Code of Audit Practice which all firms appointed to carry out local authority audits must follow. A new code was put in place for 2015-16 onwards. Not all accounting firms will be eligible to compete for the work. Such firms 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 the Council's current auditor. It is unlikely that small local independent firms will meet the eligibility criteria.

- 3.5 The Council will need to take action to implement new arrangements for the appointment of external auditors from April 2018. In order that more detailed proposals can be developed the Council needs to give early consideration to the preferred approach.
- 3.6 The Council was asked by the LGA for an indication of the preferred approach in order that it can invest resources in providing appropriate support to councils. The LGA is strongly supportive of the sector led body approach as it believes this offers best value to councils by reducing set-up costs and having the potential to negotiate lowest fees.
- 3.7 The Director of Finance gave a non-binding indication that the sector-led approach was likely to be the preferred option. He did this as this appears to be the only practicable option for a small Council like Eden and the lack of an appetite for a collaborative procurement covering Cumbrian councils. The latter would have required a separate pan Cumbrian audit panel. A national approach i.e. the sector-led option was clearly preferred.
- 3.8 The Department of Communities and Local Government has advised that opting in to a sector led approach will require a decision of full Council.

4. Options for Local Appointment of External Auditors

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

4.1 Option 1

To make a stand-alone appointment

In order to make a stand-alone appointment the Council would need to set up an Auditor Panel. The members of such a 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 would not have a majority input to assessing bids and choosing which firm of accountants to award a contract for the Council's external audit. A new independent auditor panel established by the Council would be responsible for selecting the auditor.

Advantages/Benefit

Setting up an auditor panel would allow the Council to take maximum advantage of the new local appointment regime and have local input to the decision.

Disadvantages/Risks

Recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract is estimated by the LGA to cost the average Council in the order of £15,000 plus on going expenses and allowances. Whilst this would be less for a very small Council like Eden, the cost would probably run into thousands.

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

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

4.2 Option 2

Set up a Joint Auditor Panel/Local Joint Procurement Arrangements

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 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 to assess the appetite for such an arrangement.

Advantages/Benefits

The costs of setting up the panel, running the bidding exercise and negotiating the contract will 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.

Disadvantages/Risks

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.

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.

As noted below, there appears to be no appetite for a collaboration approach across Cumbria. Collaborating with any other group would not be very practicable.

4.3 Option 3

Opt-in to a Sector Led Body

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. An 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

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

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

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

The appointment process would not be ceded to locally appointed independent members. Instead a separate body 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.

Disadvantages/Risks

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

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.

5 The Way Forward

- 5.1 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.

- 5.2 The LGA are working on developing a Sector Led Body. In a recent survey, 58% of respondents expressed an interest in this option. Greatest economies of scale will come from the maximum number of councils acting collectively and opting-in to a SLB. In order to strengthen the LGA's negotiating position and enable it to more accurately evaluate the offering the Council is asked to consider whether it is interested in the option of opting in to a SLB. It is proposed that:
- Council makes an in principle decision that this is its preferred option; and
 - the final confirmation is delegated to the Director of Finance in consultation with the Chairman of the Accounts and Governance Committee. This will be given when the details of the sector-led offer are known.
- 5.3 From discussions at Cumbria Chief Finance Officers' Group, it is clear that all Cumbrian local authorities are likely to support the sector-led approach. The County Council's Audit and Assurance Committee has already recommended this option to its full Council.

6. Policy Framework

- 6.1 The Council has four corporate priorities which are:
- Decent Homes for All
 - Strong Economy, Rich Environment
 - Thriving Communities
 - Quality Council
- 6.2 Procuring a good quality external auditor at a cost effective price would support the Council's priority of 'Quality Council'.

7. Implications

7.1 Legal

- 7.1.1 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;
- 7.1.2 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.
- 7.1.3 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.
- 7.1.4 It is anticipated that PSAA Ltd will be specified by DCLG as the Appointing Person under the Local Audit (Appointing Person) Regulations 2015. PSAA can then formally issue invites to opt-in. PSAA will let the contract with the firms, comply with OJEU etc and then make appointments of individual firms to opted-in authorities.

7.2 Financial

- 7.2.1 Any decision to reduce or increase resources must be made within the context of the Council's stated priorities, as set out in its Council Plan 2015-19 as agreed at Council on 17 September 2015.
- 7.2.2 The external auditor's fee for 2015/16 is £50,590. This is made up of £41,940 for the audit of the accounts and £8,650 for the audit of the housing benefits claim.
- 7.2.3 Current external fees levels are likely to increase when the current contracts end in 2018.
- 7.2.4 If Option 1 or Option 2 were to be chosen, the cost of establishing a local or joint Auditor Panel will need to be estimated and included in the Council's future budget for 2016/17 and 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.
- 7.2.5 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.

7.3 Equality and Diversity

- 7.3.1 The Council has to have regard to the elimination of unlawful discrimination and harassment and the promotion of equality under the Equality Act 2010 and related statutes.
- 7.3.2 There are no equality and diversity implications relating to this.

7.4 Environmental

- 7.4.1 The Council has to have due regard to conserving biodiversity under the Natural Environment and Rural Communities Act 2006.
- 7.4.2 There are no environmental implications arising from this report.

7.5 Crime and Disorder

- 7.5.1 Under the Crime and Disorder Act 1998, the Council has to have regard to the need to reduce crime and disorder in exercising any of its functions.
- 7.5.2 A high quality auditor will support the Council's anti-fraud framework.

7.6 Children

- 7.6.1 Under the Children's Act 2004, the Council has to have regard to the need to safeguard and promote the welfare of children in the exercise of any of its functions.
- 7.6.2 There are no children implications arising from this report.

7.7 Risk Management Implications

- 7.7.1 Having a good external audit in place is an important control mechanism in the Council's risk management environment. The proposed approach will help to ensure a high quality auditor is appointment is made whilst minimising the direct and indirect cost of the procurement process and ensuring the costs of the audit service are minimised through, in effect, collaborative procurement.

David Rawsthorn
Director of Finance

Governance Checks:

Checked by, or on behalf of, the Chief Finance Officer	✓
Checked by, or on behalf of, the Monitoring Officer	✓

Background Papers:

The Local Audit and Accountability Act 2014

E-mails from LGA

E-mails from Public Sector Audit Appointments Limited

Report to Cumbria County Council Audit and Assurance Committee – 21 March 2016

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