



Audit Committee
23 March 2016

Report from the Chief Finance Officer

For Information

Wards affected:
ALL

Changes to arrangements for appointment of External Auditors

1. Purpose of Report and Summary Points

- 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 will need to consider the options available and put in place new arrangements in time to make a first appointment by 31 December 2017.

2. Recommendations

- 2.1. The Audit Committee is recommended to note the three options available:
 - a) Establishing a stand-alone independent Auditor Panel to make the appointment on behalf of the Council;
 - b) Commencing work on exploring the establishment of local joint procurement arrangements with neighbouring authorities; and
 - c) Supporting the Local Government Association (LGA) in setting up a national Sector Led Body by indicating intention to "opt-in".
- 2.2. The Audit Committee is recommended to note that option 2.1(c) is at this stage the preferred option, but that this does not commit the council at this stage.

- 2.3. Note that a further report should be brought to Cabinet in due course confirming the way forward and granting authority for the procurement.

3. Background to the issue

- 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 KPMG, 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 we have benefited from reduction in fees in the order of 50% compared with historical 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. The Council's current external audit fees are £0.2m per annum.
- 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. The scope of the audit will still be specified nationally and 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 thought unlikely that small local independent firms will meet the eligibility criteria.

4. Options for local appointment of External Auditors

- 4.1. 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

- 4.2. 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. A new independent auditor appointment panel established by the Council will be responsible for selecting the auditor.

Advantages/benefit

- 4.3. 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

- 4.4. 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. It is also unclear whether the council will be able to attract sufficient individuals with the requisite skills and experience to undertake the role. Recent adverts for the independent chair of the audit committee and pensions board (which roles require a broadly similar level of skill and experience) have not attracted significant numbers of qualified applicants.
- 4.5. The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
- 4.6. The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by elected members.
- 4.7. There is a more fundamental issue. Selecting one's own external auditor may seem superficially attractive, but many would argue that it creates risk of conflict of interest and does not promote best governance. Independent appointment of the auditor provides a separation which strengthens any audit findings especially if they are positive. Whilst the creation of an independent auditor appointment panel is intended to create this independence it is unclear the extent to which it would in practice achieve this.

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

- 4.8. 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 to assess the appetite for such an arrangement.

Advantages/benefits

- 4.9. The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
- 4.10. 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

- 4.11. 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 possibly only one elected member representing each Council, depending on the constitution agreed with the other bodies involved.
- 4.12. Although this creates more separation and independence and hence reduces the risk of conflict of interests set out in paragraph 4.7 it does not wholly remove the issue.
- 4.13. 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. These issues could be overcome through the procurement process, but might be somewhat complicated to resolve, and the choice of partner councils would be critical.

Option 3 Opt-in to a sector led body

- 4.14. 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

- 4.15. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities
- 4.16. 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

- 4.17. Any conflicts at individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.
- 4.18. 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. This therefore resolves the point about conflict and governance that arises from local appointment.

Disadvantages/risks

- 4.19. Individual elected members will have little or no opportunity for direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.
- 4.20. 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.
- 4.21. Rates may be set at a national level, which could arguably involve a degree of cross-subsidy from larger authorities to smaller ones. It is difficult at this stage to estimate what, if any, would be the impact of this for Brent.

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. A formal decision to opt-in will be required at a later stage.

6. Risk Management

- 6.1. There is no immediate risk to the Council, however, early consideration by the Council 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.

- 6.2. 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. It will not commit the council to a particular course of action, and a subsequent decision will, in due course, be required by Cabinet.

7. Legal implications

- 7.1. 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;
- 7.2. 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.
- 7.3. 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. Financial Implications

- 8.1. Current external fees levels are likely to increase when the current contracts end in 2018. As set out in paragraph 3.3, this is because the current contracts were let with greater economies of scale than are likely to be the case in the future, due to the inclusion of NHS bodies. This is likely to be relevant whichever option is selected.
- 8.2. There are some costs associated with the procurement, regardless of the route chosen, but it is reasonable to assume that these will be lower under the LGA SLB approach. The cost of establishing a local or joint Auditor Panel would also need to be taken into account if the members of that were to be remunerated.
- 8.3. However, in a contract of this nature the financial evaluation would usually be weighted less heavily than in some other procurements. External audit provides a vital element of the council’s governance framework, and the cost differentials between the different options are unlikely to be so large as to be the determining factor.

9. Conclusion and Next Steps

- 9.1. 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/Committee is asked to give early consideration to the preferred approach.
- 9.2. The Council has been 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 SLB approach as it believes this offers best value to Councils by reducing set-up costs and having to potential to negotiate lowest fees.

Background Papers

Contact Officers

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