

HAMBLETON DISTRICT COUNCIL

Report To: Cabinet
6 September 2016

**Subject: SECTOR LED BODY FOR APPOINTMENT OF EXTERNAL AUDITORS – OPT- IN
2016/17**

All Wards
Portfolio Holder for Economic Development and Finance: Councillor P R Wilkinson

1.0 PURPOSE AND BACKGROUND:

- 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.
- 1.3. The existing appointment of Ernst & Young as the Council's External Auditors for 2016/17 and 2017/18 was managed by Public Sector Audit Appointments Ltd (PSSA), an independent company, established by the Local Government Association (LGA) under the transitional arrangements.
- 1.4. There are three options available to the Council for appointing External Auditors in the future:
 - Option 1: Establish its own independent auditor panel (Part 3, section 9 and schedule 4 of the Local Audit and Accountability Act 2014). The panel must be made up of a majority or of wholly independent members and must be chaired by an independent member.
 - Option 2: Establish a joint independent auditor panel to carry out the function on behalf of two or more Councils.
 - Option 3: Opt-in to an approved sector led body (SLB) to be specified by Department for Communities and Local Government (DCLG) to act as the Appointing Person on behalf of opted-in authorities. The opt-in sector led body approach requires Full Council Approval (Regulation 19, Local Audit (Appointing Person) Regulations 2015).
- 1.5. Further information on the changes to arrangements for appointment of External Auditors and the three options is attached at Annex 'A'.
- 1.6. The Department for Communities and Local Government has specified Public Sector Audit Appointments Ltd (PSSA) as the Appointing Person, establishing it as a sector led body. If the Council opt-in to the sector led body approach this arrangement can be used and will deliver economic and efficiency benefits.
- 1.7. The Local Government Association is supporting this sector led approach in order to secure the benefits of economies of scale and savings in terms of the administrative burden on Councils and other local government sector bodies. These benefits include:
 - Purchasing power to negotiate competitive audit fees worth an estimated £30m annually.

- Savings on the costs of Invitation to Tender exercises at some 470 local government sector bodies alone.
- Savings on the costs of bid appraisal, contract specification and negotiation.
- Economies of scale to be achieved from collective procurement, enabling the firms to plan and resource audits more efficiently and effectively.
- Quality monitoring and other information sharing across contracts (subject to protections over confidentiality).
- Sensible distribution of audit appointments taking into consideration joint working between individual Councils and other public bodies, managing rotations where conflicts of interest arise.

1.8. It is anticipated that invitations from Public Sector Audit Appointments Ltd (PSSA) to opt-in to the sector led approach will be issued around the autumn 2016, when Full Council approval is required. The sector led body will negotiate contracts and make the appointment of External Auditor on behalf of council. The sooner that Councils opt-in to the sector led approach, the sooner certainty will be provided about the volume of work included in the Invitation to Tender and enable best possible prices to be secured.

1.9. The Council have until December 2017 to make an appointment, but 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. If the sector led approach is to be adopted confirmation is required by late autumn 2016.

2.0 LINK TO COUNCIL PRIORITIES:

2.1 The appointment of the External Auditor ensures that the Council's financial statements are true and fair and that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This ensures that the Council's service requirements are met and contributes to the achievement of the priorities set out in the Council Plan.

3.0 RISK ASSESSMENT:

3.1 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.

4.0 FINANCIAL IMPLICATIONS:

4.1 The Current external audit fee levels are likely to increase when the current contracts end in 2018.

4.2 If option 1 or 2 outlined at paragraph 1.4 were selected to establish a local or joint Auditor Panel the costs 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.

- 4.3 By selecting option 3 and opting-in to a national sector led body, this provides maximum opportunity to limit the extent of any increases in audit fee levels as by entering in to a large scale collective procurement arrangement this would remove the costs of establishing an auditor panel.
- 4.4 Current information available on audit fee levels show that savings of £24 million per annum for local government bodies could be achieved. At the very least, it is estimated by opting-in to the sector led approach, external audit fees would not rise for the foreseeable future:

Revenue Effects	2016/17	2017/18	2018/19	2019/20
	£	£	£	£
External Audit fees	40,754	40,754	40,754	40,754

5.0 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.

6.0 EQUALITY/DIVERSITY ISSUES:

- 6.1 There are no specific equality implications to this report.

7.0 RECOMMENDATIONS:

- 7.1 That Cabinet approves and recommends to Council to Opt-in to an approved sector led body, specifically Public Sector Audit Appointments Ltd, to act as the Appointing Person for the Appointment of External Auditors for the Council.

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Background papers: None

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CHANGES TO ARRANGEMENTS FOR APPOINTMENT OF EXTERNAL AUDITORS

Background to the issue

- 1.1. 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.
- 1.2. The Council's current external auditor is Ernst & Young, 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 Local Government Association (LGA) with delegated authority from the Secretary of State Communities & Local Government (CLG). Over recent years we have 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. The Council's current external audit fees are £40,754 per annum.
- 1.3. 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.
- 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 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.

Options for local appointment of External Auditors

- 1.5. 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

- 1.6. 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 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. 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 panel established by the Council will be responsible for selecting the auditor.

Advantages/benefit

- 1.7. 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

- 1.8. 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
- 1.9. The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
- 1.10. The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by elected members.

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

- 1.11. 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 (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

- 1.12. The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
- 1.13. 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

- 1.14. 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.

- 1.15. 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

- 1.16. In response to the consultation on the new arrangement the Local Government Association (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 Sector Led Body (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

- 1.17. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities.
- 1.18. 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.
- 1.19. Any conflicts at individual authorities would be managed by the Sector Led Body (SLB) who would have a number of contracted firms to call upon.
- 1.20. 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 Local Government Association (LGA) are considering setting up such a body utilising the knowledge and experience acquired through the setting up of the transitional arrangements.

Disadvantages/risks

- 1.21. Individual elected members will have less opportunity for direct involvement in the appointment process other than through the Local Government Association (LGA) and/or stakeholder representative groups.
- 1.22. In order for the Sector Led Body (SLB) to be viable and to be placed in the strongest possible negotiating position the Sector Led Body (SLB) will need Councils to indicate their intention to opt-in before final contract prices are known.