

ASSEMBLY

25 January 2017

Title: Options for the Appointment of an External Auditor	
Report of the Cabinet Member for Finance, Growth and Investment	
Open report	For Decision
Wards Affected: None	Key Decision: No
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Accountable Director: Kathy Freeman, Finance Director	
Accountable Strategic Director: Claire Symonds, Chief Operating 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 after the 2017/18 audits. The Council is required to consider the options available and put in place new arrangements in time to make a first appointment by 31 December 2017. The Public Accounts and Audit Select Committee were consulted on 5 December 2016 and in noting the recommendation for option 3, requested that officers to explore the possibility of considering option 2 (to set up a Joint Auditor Panel/local joint procurement arrangements) and asked that their recommendation should be included in the report to Assembly at its meeting on 25 January 2017 for final decision.	
Recommendations The Assembly is recommended to: (i) Consider the options appraisal set out in the report for appointing the External Auditor by 31 December 2017; and (ii) Endorse the proposal that the Council opt-in to the sector-led body approach as set out in option 3 in the report and that the external auditor for the Council and for the Pension Fund, from 2018/19, be appointed by Public Sector Audit Appointments Ltd.	

1. Introduction and Background

- 1.1. The Local Audit and Accountability Act 2014 ended 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.

- 1.2. 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 Local Government Association (LGA) with delegated authority from the Secretary of State.
- 1.3. When the current transitional arrangements come to an end on 31 March 2018 the Council will become responsible for the appointment of the external auditor. There are several routes by which this can be undertaken, each with varying risks and opportunities.
- 1.4. 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.
- 1.5. Not all accounting firms will be eligible to compete for the work, accounting 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. Current indications are that fewer than 10 large firms will register, including the Council's current auditor, meaning that small local firms will not be eligible to be appointed to local audit roles.

2. Options for the Local Appointment of External Auditors

2.1. There are three broad options open to the Council, these are:

2.2. **Option 1** - To make a stand-alone appointment

2.2.1. The Council will need to set up an Auditor Panel consisting wholly of or with 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. The Auditor Panel will be responsible for making recommendations on the appointment of external auditors but the decision itself will be made by the Council.

Advantages/benefit

2.2.2. Setting up an Auditor Panel would allow the Council to take maximum advantage of the new local appointment regime and have local input into the decision.

Disadvantages/risks

2.2.3. Recruitment and servicing of the Auditor Panel, running the procurement exercise and negotiating and managing the external audit contract is estimated by the LGA to cost approximately £15,000 plus on going expenses and allowances.

2.2.4. The Council will not benefit from any reduction in fees that may be available through joint or national procurement contracts.

2.3. **Option 2 - Set up a Joint Auditor Panel / local joint procurement arrangements**

2.3.1. The Act enables the Council to join with other authorities to establish a joint Auditor Panel. Again, as stated above, this will 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 and depends on the appetite across neighbouring authorities for such an arrangement.

Advantages/benefits

2.3.2. The costs of setting up and servicing the panel, running the procurement exercise and negotiating and managing the contracts will be shared across many authorities.

2.3.3. 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

2.3.4. The Panel will be appointed by all partner authorities and not just by this authority thus reducing local input.

2.3.5. The choice of auditor could be complicated where the preferred auditor has a conflict of interest in relation to one of the appointing councils but not the others.

2.4. **Option 3 - Opt into a National Procurement Scheme: the “Appointing Person” arrangement offered by Public Sector Audit Appointments Ltd (PSAA)**

2.5.

2.5.1. PSAA, the organisation that currently manages the audit contracts under the transitional arrangements has successfully applied to the Department for Communities & Local Government (DCLG) to be appointed to deliver and manage a national procurement scheme to make auditor appointments to principal local government bodies.

Advantages/benefits

2.5.2. 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 local government bodies.

2.5.3. 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.

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

- 2.5.5. Any conflicts at individual authorities would be managed by the PSAA who would have a number of contracted firms to call upon.
- 2.5.6. It could be seen as being more transparent for an entirely independent body to be responsible for appointing the Councils auditors, rather than the council itself.

Disadvantages/risks

- 2.5.7. Individual elected members will have little or no opportunity for direct involvement in the appointment process other than through the LGA and the stakeholder representative groups.
- 2.5.8. In order for PSAA to be in the strongest possible negotiating position they will need Councils to indicate their intention to opt-in before final contract prices are known.

3. Public Sector Audit Appointments Ltd (PSAA)

- 3.1. Public Sector Audit Appointments Limited (PSAA) has been designated as an appointing person under the Local Audit (Appointing Person) Regulations 2015. If the Council so decides, PSAA would, as Appointed Person, have power to appoint external auditors on behalf of the Council in respect of audits of the accounts from 2018/19 onwards.
- 3.2. PSAA is a not for profit company owned by the Local Government Association's Improvement and Development Agency (IDeA) and was originally established to operate the transitional arrangements following closure of the Audit Commission. PSAA will continue to operate as an independent company. Governance arrangements and founding documents will be amended to reflect the company's change from transitional body to an Appointing Person.
- 3.3. The PSAA Board currently consists of a non-executive Chairman and three other non-executive directors, supported by a Chief Officer and eleven members of staff.

The Board members are:

- Steve Freer (Chairman), former Chief Executive CIPFA;
- Caroline Gardener, Auditor General Scotland;
- Dr Clive Grace OBE, former Deputy Auditor General Wales; and
- Stephen Sellers, Solicitor, Gowling WLG (UK) LLP.

Chief Officer

- Jon Hayes, former Audit Commission Associate Controller.

- 3.4. Further information is available from the PSAA website at www.psaa.co.uk

4. Tender Process

- 4.1. PSAA will run the tendering exercise, and will evaluate bids and award contracts. The number of firms eligible to undertake local public audit will be regulated

through the Financial Reporting Council and the recognised supervisory bodies. Only appropriately accredited firms will be able to bid for appointments.

5. Contracts

5.1. To secure the best prices, PSAA will let audit contracts:

- for five years;
- in two large contract areas, nationally, with three or four contract lots per area, depending on the number of bodies that opt in; and
- to a number of firms in each contract area to help manage independence issues.

5.2. The value of each contract will depend on prices bid, with firms offering the best value being awarded larger amounts of work. Having contracts with a number of firms will help manage issues of independence and avoid market dominance by one or two firms. Limiting the national volume of work available to any one firm will encourage competition and ensure the plurality of provision.

5.3. Contracts are likely to be awarded at the end of June 2017.

6. Fees

6.1. PSAA have stated that they will ensure that fee levels are carefully managed by securing competitive prices from firms and by minimising their own costs. Costs for setting up and managing the scheme will also need to be covered by audit fees. PSAA intend to fund an element of the costs of establishing the scheme, including the costs of procuring audit contracts, from local government's share of PSAA's current deferred income. PSAA think this is appropriate because the new scheme will be available to all relevant principal local government bodies.

6.2. PSAA will pool scheme costs and charge fees to audited bodies in accordance with a scale of fees which have regard to size, complexity and audit risk. Pooling means that everyone in the scheme should 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 scale of fees.

6.3. Scale fees will be determined by the prices achieved in the auditor procurement. Once contracts are awarded 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.

6.4. PSAA will return any surplus funds to scheme members under their articles of association and memorandum of understanding with the DCLG and the LGA.

7. Opting into the National Scheme

7.1. The Council has received an invitation from PSAA to opt into the national scheme for auditor appointment. Formal acceptance is required to be received by PSAA no later than 9 March 2017. If acceptance is not received by the closing date, the Council could subsequently make a request to opt in but only after 1 April 2018. This means that the Council would have to make its own auditor appointment to undertake the 2018/19 audit of accounts.

- 7.2. PSAA expects to have consulted upon and made auditor appointments to local authorities by end of December 2017.
- 7.3. The relevant regulations require that the decision to accept the invitation to opt into the national scheme arrangement needs to be made by the members of the authority meeting as a whole. A report will be taken to Assembly on the 25 January 2017.
- 7.4. The Public Accounts and Audit Select Committee is therefore requested to consider the information in the report and comment accordingly.

8. Preferred Option

- 8.1. For the reasons set out above, officers recommend that Option 3, the sector led approach, is the most appropriate option for the Council to follow and that the recommendation should be made to Assembly to approve a sector led approach and to opt in to appointing person arrangements.

9. Financial Implications

Implications completed by: Stephen Hinds, Chief Accountant

- 9.1. The report provides information on the new arrangements for appointing an external auditor to undertake the audit of the Council's accounts from 2018/19.
- 9.2. Although the Council has until December 2017 to make an auditor appointment, in practical terms, this means one of the options outlined in this report will need to be in place within the next few months in order that the contract negotiation process can be carried out during 2017.
- 9.3. Greatest economies of scale will come from the maximum number of Councils acting collectively as set out in option three. Should Council be minded to choose the national scheme option offered by PSAA, it will be required to opt into the arrangement before the cost of audit fees for the 2018/19 audit of accounts is known. However, the option to appoint auditors through the national scheme should deliver the most financial benefit to the Council, by reducing set-up costs and having the potential to negotiate the lowest fees.
- 9.4. The current audit fee for undertaking the 2015/16 audit of the Council's accounts was £166k and £21k for the pension fund. Any increase in fees for the 2018/19 audit will put a financial pressure on the future budgets.

10. Legal Implications

Implications completed by: Dr. Paul Feild – Senior Governance Lawyer

- 10.1. To participate, principal authorities are required to have "opted in" to the appointing person arrangement. Under regulation 19 of the Local Audit (Appointing Person) Regulations 2015, the decision to opt in must be made by full Council.

10.2. When a principle authority opts into an appointing person arrangement, they are required by regulation to remain opted in for the “compulsory appointing period”. This is the financial period for which a relevant appointing person is responsible for appointing a local auditor to conduct the audit of the authority’s accounts. The compulsory appointing period cannot exceed five consecutive years. At the end of the compulsory appointing period the Council can opt into another appointing person arrangement or pursue other options.

Public Background Papers Used in the Preparation of the Report:

- Invitation to opt into the National Scheme for Auditor Appointments – Letter from PSAA dated 27/10/16
- The Local Audit and Accountability Act 2014.
- The Local Audit (Appointing Person) Regulations 2015

List of appendices: None