

COUNCIL

9 January 2017

APPOINTMENT OF EXTERNAL AUDITOR

Report of the Director for Resources

Strategic Aim:	All	
Exempt Information	No	
Cabinet Member(s) Responsible:	Councillor Terry King, Leader and Portfolio Holder for Corporate Finance	
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Ward Councillors	N/A	

DECISION RECOMMENDATIONS

That Council opts in to the national sector-led arrangements and nominates Public Sector Audit Appointments Limited (PSAA), to appoint the external auditor on its behalf.

1 PURPOSE OF THE REPORT

- 1.1 To ask Council to consider the options for appointing the external auditor and recommend a way forward.

2 BACKGROUND AND MAIN CONSIDERATIONS

2.1 Overview

- 2.1.1 The Local Audit and Accountability Act 2014 received Royal Assent in 2014 and has been brought into force on various dates since. It brings about changes to the external audit regime for local authorities in particular relating to the future appointment of External Auditors and how local authorities can in effect make their own appointment.
- 2.1.2 The 2014 Act must be considered alongside the Local Audit (Appointing Person) Regulations 2015 which provides an additional option, in that a sector lead appointing person makes the appointment of the auditor (on behalf of the local authority), avoiding the need for local authorities to undertake a procurement exercise.

2.1.3 This report sets out the background and various options and suggests a preferred option.

2.2 Local Audit and Accountability Act 2014

2.2.1 The Local Audit and Accountability Act 2014 abolished the Audit Commission and (subject to transitional provisions) repealed the Audit Commission Act 1998. Its aim, as stated in DCLG guidance, is to give local bodies the freedom to appoint their own auditors from an open and competitive market and to manage their own audit arrangements, with appropriate safeguards to ensure independence. Under the Audit Commission regime external auditors were appointed by the Commission and periodically rotated as a means of ensuring independence.

2.2.2 The new local arrangements for the appointment of auditors were originally expected to start after the Commission's current contracts with audit suppliers ended in 2016/17. However, the Secretary of State has extended current contracts by 1 year to include the 2017/18 year. Therefore, arrangements for new auditors to audit the 2018/19 accounts will need to be finalised by 31st December 2017, so that the new auditors are in place by 1st April 2018. This Council is a "relevant authority" within the scope of the Act, being listed in Schedule 2.

2.2.3 Part 3 of the Act (and Schedule 3) deals with the appointment of local auditors (unless appointed under the Local Audit (Appointing Persons) Regulations 2015) and is explained below in 2.3. The key points of interest are:

- Appointments may last for more than one year but a new appointment must be made at least once every five years – this does not prevent the re-appointment of an auditor. An authority may appoint two or more local auditors at once, either acting jointly or separately;
- The auditor(s) must be eligible (under Part 4 and Schedule 5 of the Act) and independent of the body being audited;
- Schedule 3 paragraph 1(1) provides that the auditor(s) must be appointed by the Council (rather than by the Executive); and
- Auditors must be appointed by the end of 31st December in the financial year before the financial year which will be covered by the accounts to be audited.

2.2.4 Section 8 of the Act sets out the procedure for appointing auditors if appointed by the Council and imposes an obligation to consult and take into account the advice of the auditor panel on the selection and appointment of a local auditor. There is also a requirement to publicise the appointment.

2.2.5 If the appointment is not to be made by the Appointed Person, Section 9 of the Local Audit and Accountability Act 2014 requires the Council to have an auditor panel whose role is to advise the Authority on:

- The maintenance of an independent relationship with the appointed local auditor(s);
- The selection and appointment of a local auditor; and

- Any proposal to enter into an agreement limiting the liability of its auditor(s), if the Council wanted to enter into such an agreement it would be a matter for the full Council.

2.2.6 Schedule 4 makes more detailed provision about auditor panels. Paragraph 1 provides that the panel must be one of the following:

- An auditor panel specifically appointed as such by the Authority; or
- An auditor panel jointly appointed as such with one or more other authorities; or
- A committee (or sub-committee) of the Authority which meets the specified requirements for auditor panels (see below) and which has agreed to be the Authority's auditor panel.

2.2.7 For this Council, this would mean the Audit and Risk Committee. If this Council chose this approach, the constitution of the Audit and Risk Committee would need to change to include an independent chairman and a majority of independent members. For this Council, the appointment of the auditor panel would be a matter for the full Council.

2.2.8 Paragraph 2 of Schedule 4 of the Act deals with the constitution of auditor panels. It has been amended by the Local Audit (Auditor Panel Independence) Regulations 2014 which inserted a revised definition of "independence". An auditor panel must consist of a majority of (or wholly of) independent members, and must be chaired by an independent member.

2.2.9 The amendments to Paragraph 2 of Schedule 4 of the Act make specific provision relating to the Council. Paragraph 2 (2) of Schedule 4 of the Act now provides that a member of its auditor panel cannot be "independent" as required if (s)he has been a:

- Member or officer of the Council within the previous five years; or
- Member or officer of another relevant authority, or an officer or employee of another entity, where the other relevant authority or entity is "connected with" the Council.

2.2.10 Other categories of person who are excluded from being independent members are those "connected with" current/prospective auditors; relatives or close friends of members/officers of relevant authorities and connected authorities and entities; and persons who have entered into contracts with the authority.

2.2.11 In summary, the Act sets out a framework which must be applied if a local authority appoints its own auditor. For this Council and others appointing an auditor would pose two key challenges:

- It would need to put an auditor panel in place and go through a process of appointing independent members; and
- It would need to undertake a new procurement exercise - and incur the costs that go with it – for a service it has never previously commissioned directly.

2.2.12 Other than the Council being able to choose its own auditors, the officer view is that there is very little to be gained from the new legislation particularly with the costs of audit having reduced significantly over the last few years.

2.3 Local Audit (Appointing Person) Regulations 2015

2.3.1 The new regulations allow local government to establish collective procurement arrangements. The regulations set out the process for the Government to approve an organisation to act as a sector-led body. The Secretary of State has designated Public Sector Auditor Appointments (PSAA) Ltd, a sector-led body recommended by the local government sector as an appointing person and given them the necessary powers and duties to act as a collective procurement body. This means that PSAA can make auditor appointments to relevant principal local government bodies that choose to opt into the national appointment arrangements being developed, for audits of the accounts from 2018/19. PSAA will also set scale fees (indicative fees per Council). A Questions and Answer paper has been produced by PSAA and is attached at **Appendix A**.

2.3.2 The regulations set out the process by which authorities can choose to participate in the sector-led arrangements. Essentially, the appointed person must invite authorities to become opted in authorities. The authorities to whom the invitation is issued must then individually decide whether to accept the invitation. The decision to accept the invitation may only be accepted by Full Council. If an authority accepts then, the appointment of the auditor is made by the appointing person. The regulations also set out the powers and functions of the appointing person which include, for example, a power to levy fees on opted-in authorities and a corresponding duty on the body to consult before setting those fees.

2.3.3 These regulations modify parts of the Local Audit and Accountability Act 2014, as they apply to authorities that have opted in to the collective procurement arrangements. This includes the provision that Authorities that opt in and do not make their own appointment will not need to establish an independent auditor panel. The regulations still requires the Appointing Person to make a new appointment at least every five years.

2.3.4 New appointments, for the 2018/19 accounts for principal local government bodies, must be made under the provisions of the 2014 Act and confirmed by 31 December 2017. The aim is to award contracts to audit firms by June 2017, giving six months to consult on appointments with authorities before the 31 December 2017 deadline. The Council must decide whether to opt-in by the 9 March 2017.

2.4 The value of external audit – what does the Council want?

2.4.1 In thinking about how the external auditor might be appointed officers have set out what the Council wants from its external audit service which one might consider when considering future appointment arrangements:

- **Value for money** – the Council wants a good quality service for a competitive fee. The main fee has reduced from £181k in 2007/08 to £65k in 2016/17 and the current service continues to be good. Based on fee reductions achieved, it is unlikely that further savings can be made. One of the key benefits of the current collective procurement arrangements is that

firms bid for a block of work rather than individual audits and this has been one of the main factors in reducing fees.

- **High quality audit** – the Council values its audit opinion as it is one assessment of how it is carrying out its public stewardship role. The Council would want to maintain a high quality audit as a means of reassuring residents that they can have confidence in this opinion.
- **Independence** – the Council believes that the auditor must be independent and be seen to be independent. Whilst auditors are required to be independent under their own professional standards, the current arrangement whereby auditors have been appointed by a third party does add an extra layer of assurance.
- **Minimal administration and procurement cost** – the Council does not appoint its own auditor and hence does not incur any direct cost. It would be looking to keep the cost of any new process to a minimum.

2.4.2 Council might think there are other factors that should be considered and these should be borne in mind in respect to any decision.

3 CONSULTATION

3.1 The decision is a matter for Full Council and no formal external consultation is required. As the Audit and Risk Committee oversees the work of external audit on behalf of Council its views have been sought and they support the recommendation to opt-in. The Leader is also supportive of this route.

4 ALTERNATIVE OPTIONS

4.1 Officers have set out alternative options below with some comments.

4.2 **Option 1.** The Council could seek to opt in to the sector lead procurement of the external audit service. Using Public Sector Audit Appointments as the Appointing Person is attractive as it removes a great deal of administration and arrangements that will need to be put in place and improves the effectiveness of procuring in what is a specialised activity area. The market for this service is very limited and at present, only the larger accounting firms have the accreditation, experience and specialist staff to undertake the work. These firms would be much more likely to bid for work through a bigger procurement exercise rather than seek work from one or two isolated councils. This option is attractive.

4.3 If the Council chooses not opt in to sector led arrangements, there are two possible alternatives:

4.4 **Option 2.** The Council could form its own auditor panel and undertake its own procurement arrangements. The small size of the audit contract may not be attractive to the bidders, who in reality are likely to be from the bigger accounting firms. So the Council may see a rise in fee but this is uncertain. This approach also raises the question as to whether there is an available and willing source of independent members across Rutland to appoint to the auditor panel, recognising that there will need to be a majority of independent members, including the chair on the panel. The panel will have limited responsibilities and in reality will meet infrequently, and the role may not be seen as attractive. This option would require

work, is likely to increase cost and offers little benefit.

- 4.5 **Option 3.** The Council could seek to form a joint auditor panel and a joint procurement arrangement with neighbouring authorities (this could be within Leicestershire or elsewhere) so that there is a single auditor panel and single external audit contract for the entire area (however defined). This would aim to take advantage of better purchasing power and provide a more attractive offer for the external auditor bidders. This is particularly important as local authority audit is a specialised activity. The market for this service may develop, but we should not assume it will, and at present, only the larger accounting firms have the experience and specialist staff to undertake the work. A contract for Leicestershire and Rutland would be more attractive and would potentially maintain economies of scale. However, at the Leicester, Leicestershire and Rutland Section 151 officers meeting, there has been little interest in developing such an arrangement as most are intending to opt in to the sector led arrangements.
- 4.6 There would still be some additional bureaucracy associated with creation and management of a joint auditor panel, although it would avoid the need for each body to source its own independent members. This approach would require delegations from (or feasibly to) this Council from other Councils to form a lead authority for the appointment of the panel and for future governance and procurement purposes. There would also need to be joint arrangements in place to introduce and manage an allowance scheme for the panel. Whilst more attractive than option 2, it is only viable if the Council can find other Councils going down this route.
- 4.7 Option 1 effectively replicates existing arrangements for the Council. Options 2 and 3 will require officer time to introduce these arrangements. There will be costs associated with advertising and then interviewing for the independent members and running a procurement exercise. Subsequently there could be the cost of an allowance scheme. It is recommended that Option 1 is pursued. Officers believe the national collective scheme that PSAA is developing is the most likely route for securing good quality at reasonable cost and is by far the most convenient approach.

5 FINANCIAL IMPLICATIONS

- 5.1 The current cost of audit is c£70K (main fee and other work). It is assumed that the fees to be set by PSAA will be in this range but this will not be known until the formal procurement exercise is complete.
- 5.2 Should the Council undertake its own procurement, then additional costs would be incurred through the procurement exercise, setting up a panel including payments to members and dealing with contracts etc. It is difficult to estimate costs but these could be in the region of £10k.
- 5.3 The biggest risk for the Council would be the audit fee itself and whether a local procurement exercise would deliver it the same fee as it pays now. Members should note that the audit cannot be undertaken by any firm of accountants as public sector auditors are effectively “accredited” so the same firms who bid under a collective purchasing arrangement would have to bid for our individual audit. There is not only the risk that firms would not wish to bid but that fees may go up.

6 LEGAL AND GOVERNANCE CONSIDERATIONS

- 6.1 The authorities to whom the invitation is issued must then individually decide whether to accept the invitation. The decision to accept the invitation may only be accepted by Full Council as stated in Regulation 19 of the Local Authority (Appointing Person) Regulations 2015.

7 EQUALITY IMPACT ASSESSMENT

- 7.1 An Equality Impact Assessment (EqIA) has not been completed because there are no service, policy and organisational implications.

8 COMMUNITY SAFETY IMPLICATIONS

- 8.1 There are no community safety implications.

9 HEALTH AND WELLBEING IMPLICATIONS

- 9.1 There are no health and wellbeing implications.

10 CONCLUSION AND SUMMARY OF REASONS FOR THE RECOMMENDATIONS

- 10.1 It is important that the Council has appropriate external audit arrangements in place. Opting into the sector led approach is considered to be the most favourable.

11 BACKGROUND PAPERS

- 11.1 There are no additional background papers to the report.

12 APPENDICES

- 12.1 Appendix A – Questions and Answers – Sector led arrangements

A Large Print or Braille Version of this Report is available upon request – Contact 01572 722577.

Appendix A. Questions and Answers – Sector led arrangements

1. What is the sector led body?

Public Sector Audit Appointments Limited (PSAA) has been specified as an appointing person under the Local Audit (Appointing Person) Regulations 2015 and has the power to make auditor appointments from 2018/19 on behalf of bodies who opt in, in accordance with the Regulations.

PSAA is a company owned by the LGA's Improvement and Development Agency (IDeA) and was established to operate the transitional arrangements following closure of the Audit Commission.

2. When will we need to make a commitment to opt-in?

3. When will invitations to opt-in be issued?

The date by which principal local government bodies will need to opt in to the sector led appointing person arrangement is not yet finalised. The aim is to award contracts to audit firms by June 2017, giving six months to consult on appointments with authorities before the 31 December 2017 deadline. We anticipate that invitations to opt in will be issued before December 2016.

In order to maximise the potential economies of scale from agreeing large contracts with firms, and to manage any auditor independence issues, PSAA needs as much certainty as possible about the volume and location of work it is able to offer to firms. Our provisional timetable suggests that PSAA will need to start preparing tender documentation early in 2017, so we will need to know by then which authorities want to be included.

4. Who can accept the invitation to opt in?

In accordance with Regulation 19 of the Local Audit (Appointing Person) Regulations 2015, a principal authority will need to make the decision to opt in at full council (authority meeting as a whole), except where the authority is a corporation sole (such as a police and crime commissioner), in which case the function must be exercised by the holder of the office.

5. Can we join after it has been set up or do we have to join at the beginning?

The Regulations require that once the invitations to opt in have been issued there will be a minimum period of eight weeks for you to indicate acceptance of the invitation. One of the main benefits of a sector led approach is the ability to achieve economies of scale as a result of being able to offer larger volumes of work. The greater number of participants that have signed up at the outset, the better the economies of scale PSAA are likely to achieve. This will not prevent authorities from joining the sector led arrangements in later years. However, in order to be in the best position we would encourage as many authorities as possible to commit by accepting the invitations within the specified timeframe.

6. Will membership be free for existing members of the LGA?

The option to join the sector led procurement will be open to all principal local government bodies listed under Schedule 2 of the Local Audit and Accountability Act 2014. There will not be a fee to join the sector led arrangements. The audit fees that opted-in bodies will be charged will cover the costs to PSAA of appointing auditors and managing the arrangements. We believe that audit fees achieved through large contracts will be lower

than the costs that individual authorities will be able to negotiate. In addition, by opting into the PSAA offer, bodies will avoid the costs of their own procurement and the requirement to set up an auditor panel with independent members.

7. How will we be able to influence how the SLB and associated contracts are set up?

We have not yet finalised the governance of the arrangements and are considering the options, including how best to obtain stakeholder input. PSAA are considering establishing a stakeholder engagement panel or advisory panel which can comment on the proposals. PSAA continues to work in partnership with the LGA in setting up the sector led arrangements and you can feed in comments and observations to PSAA by emailing generalenquiries@psaa.co.uk and via the LGA and their Principal Advisors.

8. Will there be standard terms and conditions?

The audit contracts between PSAA and the audit firms will require firms to deliver audits compliant with the NAO Code of Audit Practice. We are aware that bodies would like to understand how performance and delivery will be monitored and managed. This is one of the issues that could be discussed with the advisory panel (see Q7).

9. What will be the length of the contract?

The optimal length of contract between PSAA and firms has not been decided. We would welcome views on what the sector considers the optimal length of audit contract. We anticipate that somewhere between 3 and 5 years would be appropriate.

10. Will there be the opportunity of a 3 year contract with an option to extend for up to 2 years or something similar?

Please see answer to question 9.

11. In addition to the Code of Audit Practice requirements set out by the NAO, will the contract be flexible to enable authorities to include the audit of wholly owned companies and group accounts?

Local authority group accounts are part of the accounts produced under the CIPFA SORP and are subject to audit in line with the NAO Code of Audit Practice and will continue to be part of the statutory audit.

Company audits are subject to the provisions of the Companies Act 2006 and are not covered by the Local Audit (Appointing Person) Regulations 2015. Local authority companies will be able to appoint the same audit firm for any company audits as PSAA appoints to undertake the principal body audit, should they so wish.

12. Will bodies that opt in be able to seek information from providers and undertake some form of evaluation to choose a supplier?

PSAA will run the tendering exercise, and will evaluate bids and award contracts. PSAA will consult on individual auditor appointments. The appointment of an auditor independently of the body to be audited is an important feature of the arrangements and will continue to underpin strong corporate governance in the public sector. The arrangements by which audited bodies will be able to comment on the performance of firms and the arrangements made by PSAA is still being considered. Please see answers

to Questions 7 and 8.

13. Will the price be fixed or will there be a range of prices?

The fee for the audit of a body that opts in will reflect the size, audit risk and complexity of the work required. PSAA will establish a system for setting the fee which is fair to all opted-in bodies. As a not-for-profit organisation, PSAA will be able to return any surpluses to participating bodies after all costs have been met.

14. We have shared service arrangements with our neighbouring bodies and we are looking to ensure that we share the same auditor as our Fire Authority, Housing Association and Pension Fund. Will the sector led body allow for this?

PSAA will be able to make appointments to all bodies listed in Schedule 2 of the Local Audit and Accountability Act 2014 which are 'relevant authorities' and not excluded as a result of being smaller authorities e.g. parish councils. Please see the answer to question 11 in respect of companies act audits.

In setting up the sector led arrangements, one of our aims is to make auditor appointments that take account of joint working and shared service arrangements. PSAA will seek information on such arrangements to allow it to make a sensible distribution of appointments.

15. We also have a Joint Committee which does not have a statutory requirement to have an external auditor but has agreed in the interests of all parties to continue to engage with one. Is it possible to use this process as an option to procure the external auditor for the Joint Committee?

The requirement for joint committees to produce statutory accounts ceased after production of 2014/15 accounts. Joint committees that have opted to produce accounts voluntarily and obtain non-statutory assurance on them will still be able to make local arrangements.

16. How will the process ensure providers are not over-stretched and that the competition in the market place is increased?

The number of firms eligible to undertake local public audit will be regulated through the Financial Reporting Council and the recognised Supervisory Bodies (RSBs). Only appropriately accredited firms will be able to bid for appointments whether that is through PSAA or an auditor panel. The seven firms previously appointed by PSAA and the Audit Commission generally maintain a dedicated public sector practice with staff trained and experienced in public sector work.

One of the advantages of the sector led option is to make appointments that help to ensure that each successful firm has a sufficient quantum of work to make it possible for them to invest in public sector specific training, maintain a centre of excellence or hub that will mean:

- firms have a regional presence
- greater continuity of staff input
- a better understanding the local political, economic and social environment.

17. Will the process appoint a number of different external auditors and how will they be allocated?

PSAA will organise the contracts so that there is a minimum number of firms appointed nationally. The minimum is probably four or five (depending on the number of bodies that opt in). This is required, not just to ensure competition and capacity, but because each firm is required to comply with the FRC's ethical standards. This means that an individual firm may not be appointable for 'independence' reasons, for example, because they have undertaken consultancy work at an audited body. PSAA will consult on appointments to ensure the allocation meets the needs of the sector.

18. What will be the process to feed in opinions from customers of current auditors if there were issues?

PSAA will seek feedback on its auditors as part of its engagement with the sector. PSAA will continue to have a clear complaints process and will also want to undertake contract monitoring of the firms it appoints. Please see Q7 for information on how you can influence how these arrangements are established.

19. What is the timetable for set up/ key decisions?

The timetable is currently being refined and we appreciate that you will need to know when to take a recommendation to your full council or appropriate office holder (see Q4). We expect the key points in the timetable to be broadly:

- establish an overall strategy for procurement - by 31 October 2016;
- achieve 'sign-up' of scheme members - by early January 2017;
- invite tenders from audit firms - by 31 March 2017;
- award contracts - by 30 June 2017;
- consult on and make final auditor appointments - by 31 December 2017; and
- consult on, propose audit fees and publish fees - by 31 March 2018.

20. What would be the terms of reference of the body?

PSAA is wholly owned by the IDeA (the IDeA is wholly owned by the LGA). PSAA will operate as an independent company as it does now, although there will be changes to its governance arrangements and its founding documents to reflect the fact that it is no longer the transitional body. See also questions 1-8.

21. Will the body take on all audit panel roles and therefore mitigate the need for there to be one in each of the public bodies?

Opting in to the appointing person arrangement will remove the need to set up an auditor panel. This is set out in the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2015.