

**CHANGES TO ARRANGEMENTS FOR APPOINTING EXTERNAL AUDITORS**

*To:* **Audit and Accounts Committee**

*Date:* **22<sup>nd</sup> November 2016**

*From:* **Head of Integrated Financial Services**

*Electoral division(s):* **All**

*Forward Plan ref:* **N/a** *Key decision:*

*Purpose:* **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.**

*Recommendation:* **The recommendations are set out in section 4 of this report.**

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## **1. BACKGROUND**

- 1.1. The Local Audit and Accountability Act 2014 has established new arrangements for the audit and accountability of relevant public sector organisations including local authorities, clinical commissioning groups and police and crime commissioners in England.
- 1.2. The Secretary of State for Communities and Local Government decided to implement a phased introduction of the new local audit framework. There is currently a transitional period for local authorities, where the role of appointing external auditors and setting fee levels has been transferred from the now defunct Audit Committee and undertaken by the Public Sector Audit Appointments Ltd (PSAA), a subsidiary of the Local Government Association.
- 1.3. This transitional arrangement comes to an end for local authorities on 31 March 2018 with the audit of the 2017-18 financial statements. The new arrangements require local authorities to opt in to the PSAA sector-led auditor appointments, or appoint their own local external auditors, which can be done either individually or jointly with one or more other authorities by 31 December 2017.
- 1.4. The scope of the audit will continue to be specified nationally, the National Audit Office (NAO) is responsible for writing the Code of Audit Practice which all firms appointed to carry out local authorities audits 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. It is less likely that small local independent firms will meet the eligibility criteria.

## **2. LGSS PARTNERS' POSITION**

- 2.1. At present the current auditors for the LGSS Partners are all different with KPMG, Ernst and Young and BDO currently appointed as auditors for Northamptonshire County Council (NCC), Milton Keynes Council (MKC) and Cambridgeshire County Council (CCC) respectively. KPMG are also the auditors for Northampton Borough Council (NBC), one of LGSS's customers.
- 2.2. LGSS in 2015-16 has operated with a single integrated closedown team to deliver the financial statements including the external audit management across NCC, CCC and LGSS. This team has recently been expanded to incorporate the accounts and audit for both MKC and NBC.
- 2.3. Therefore there is a strong case to have a single external auditor across all LGSS partners. This will ensure the most effective management of the external audit relationships within the integrated closedown team. In addition a single auditor will enable efficiencies to be achieved in the audit processes and arrangements to help achieve the earlier statutory deadlines for the financial statements across all LGSS Partners.

- 2.4. The purpose of this report is to set out the key considerations and options available to the LGSS Partners to secure a single auditor for all the Partners.

### **3. OPTIONS FOR LOCAL APPOINTMENT OF EXTERNAL AUDITORS**

- 3.1. There are in effect two different approaches available to appoint external auditors with effect from the 1 April 2018, which are to:
- i. Opt in to the PSAA sector-led appointments process; or
  - ii. Establish an auditor panel to advise on the appointment of the local external auditor and to ensure the maintenance of independent relationships.
- 3.2 A recent LGA survey of local authorities found that 58% of authorities were expecting to 'opt in' to a sector led body, rather than appoint their own auditor. A further 35% of authorities were looking to form some kind of collective procurement arrangement.
- 3.3. Each of these options is considered further in the following sections.

#### **Option 1 PSAA Sector-Led National Scheme for Auditor Appointments**

- 3.4. The PSAA have been confirmed as the government's sector-led body to manage the auditor appointments for those authorities opting in to this arrangement.
- 3.5. The ability to negotiate lower fees with the firms as a result of being able to offer higher volumes of work is considered one of the main benefits of a sector led approach. The greater the number of authorities that have signed up at the outset, the better the economies of scale that are likely to be achieved. However there is a counter argument that being part of a sector led arrangement will increase costs due to additional requirements that the PSAA may place on any successful audit firms.
- 3.6. The general legal, financial and reputational risks of undertaking a new procurement process would be mitigated for each local authority with this approach. The sector led option would also reduce the finance, procurement, legal, internal audit management overhead and staff time associated with a new procurement and establishing a new Audit Panel (refer to option 2).
- 3.7. There will not be a fee to join the sector led arrangements, however the audit fees that opted-in bodies will be charged by PSAA will cover the costs of appointing auditors. PSAA is not for profit and will pool scheme costs and charge fees on a scale based on size, complexity and audit risk. Surplus funds will also be returned to scheme members. The PSAA believe that highly competitive audit fees will be achieved through the sector-led procurement.
- 3.8. Additionally assurances have not been received from the PSAA that the opt-in arrangements could and would guarantee a single appointment across NCC, MKC and CCC. This is a risk to LGSS in terms of managing the external audit arrangements and relationships within the Integrated Closedown team which is likely to prohibit the efficiencies that can be

achieved by the integrated team. However the PSAA do state that the scheme “will endeavour to appoint the same auditors to bodies which are involved in formal collaboration/joint working initiatives or with combined authority areas, if the parties consider that a common auditor will enhance efficiency and value for money” (PSAA, *Developing the option of a national scheme for local auditor appointments*).

- 3.9. The date by which local authorities will need to formally opt-in to the PSAA sector led appointing person arrangement is 9 March 2017. In addition to the formal agreement for any authority to opt in, the decision must be approved by the Full Council. The expectation is that the PSAA will aim to award contracts to audit firms by June 2017, giving 6 months to plan and organise which firm is appointed to each individual authority before the 31 December 2017 deadline. The expected timetable for the sector-led option is set out below.

Action / Milestone	Date
Invitation to opt in issued	27 October 2016
Full Council approval to opt in	January/February 2017
Closing date for receipt of notices to PSAA to opt in	9 March 2017
PSAA contract notice published	20 February 2017
PSAA award audit contracts	End of June 2017
PSAA consult on and make auditor appointments	End of December 2017
PSAA consult on and publish scale fees	End of March 2018

- 3.10. Authorities will not be prevented from joining the sector-led arrangements in later years but the earliest opportunity to opt in after the closing date will be after 1 April 2018 with the appointment of auditors for 2019-20 accounts. However, in order to be in the best position to negotiate good rates for authorities the PSAA is encouraging as many authorities as possible to opt in from the outset.

## **Option 2 Appoint an Independent Audit Panel and Locally Procure**

- 3.11. There are different options available if an Audit Panel approach is to be adopted which are;
- A separate and individual auditor panel, solely for one Council only;
  - A joint auditor panel with one or more other authorities, such as the LGSS Partner Authorities;
  - Using the services of or using an existing committee or sub-committee to act as the auditor panel (subject to compliance with the other provisions and regulations relating to auditor panels); or
  - Using another authority’s auditor panel to carry out the functions for another Council.
- 3.12. The use of an Auditor Panel and a local procurement would achieve the intended outcome of having a single external auditor for the LGSS Partners. However there are further complexities, risks and costs associated with this approach. For each option above a procurement

exercise will be necessary as well as full Council approval along with funding to meet the costs of a local procurement process. Costs will include the recruitment of independent appointees (members), servicing the Panel, running a bidding and tender evaluation process (and any retenders in subsequent years), letting a contract and managing the contract, and paying members fees and allowances.

3.13. CIPFA has issued guidance on the Auditor panel which can be found at: <http://www.cipfa.org/policy-and-guidance/publications/g/guide-to-auditor-panels-pdf>

3.14. The Auditor Panel must comply with the following requirements:

- The minimum number of members that an auditor panel must have is three;
- There must be a majority of independent members as well as an independent Chair. For a panel meeting to be quorate, there must be a majority of independent members present at the meeting;
- For joint auditor panels, it is likely that each authority will want to have representative members. For each additional member, there will need to be an additional independent member;
- Specific regulations clarify how independence is to be defined for the purposes of auditor panels;
- Panel members should have a certain level of specific knowledge and experience to ensure that the panel carries out its duties effectively. Authorities will need to ensure that they draft panel member job descriptions carefully and advertise widely enough to reach those potential candidates with the correct skills and experience and maximise the number of suitable applicants for those vacancies; and
- Panel members may be paid an allowance and any reasonable expenses covered, but it is for authorities to determine such arrangements themselves.

3.15. Following these principles would mean that the audit panel responsibility could not be transferred to an existing LGSS partner authority Audit Committee, due to the lack of independent members. As such a new Committee would need to be established, which would be expected to work alongside the existing Audit Committees at each LGSS Partner.

3.16. CIPFA have indicated that there is likely to only be the requirement for a few audit panel meetings during the external audit procurement exercise, and very few meetings once the external auditor has been procured. CIPFA have also advised that there would be little involvement from existing Audit Committees other than being informed of progress and decisions and offering comment.

3.17. There are a number of advantages and disadvantages of a local audit procurement exercise, overseen by an Auditor Panel, which vary depending

on the specific type of Auditor Panel that is established. These are set out in Appendix A.

#### **4. RECOMMENDATIONS AND NEXT STEPS**

##### **4.1. Taking the advantages and disadvantages of each option into consideration it is recommended that:**

- i. LGSS Partners opt-in to the PSAA sector led auditor appointment arrangements on the basis of the cost, complexity, timing and resourcing pressures are considered prohibitive in setting up a local independent Auditor Panel and separate procurement process.
- ii. Prior to the decision being taken by the Full Council to opt-in LGSS officers will write to the PSAA and request to meet with the Chief Officer at PSAA to seek assurance that a single auditor be appointed for the LGSS Partners setting out the clear rationale in terms of the efficiency and value for money that this would achieve.

#### **5. ALIGNMENT WITH CORPORATE PRIORITIES**

##### **5.1 Developing the local economy for the benefit of all**

There are no significant implications for this priority.

##### **5.2 Helping people live healthy and independent lives**

There are no significant implications for this priority.

##### **5.3 Supporting and protecting vulnerable people**

There are no significant implications for this priority.

#### **6. SIGNIFICANT IMPLICATIONS**

##### **6.1 Resource Implications**

There are no significant implications within this category.

##### **6.2 Statutory, Risk and Legal Implications**

These are set out within sector 3 of this report.

##### **6.3 Equality and Diversity Implications**

There are no significant implications within this category.

##### **6.4 Engagement and Consultation Implications**

There are no significant implications within this category.

##### **6.5 Localism and Local Member Involvement**

There are no significant implications within this category.

##### **6.6 Public Health Implications**

There are no significant implications within this category.

<b>Source Documents</b>	<b>Location</b>
The Local Audit and Accountability Act 2014 CIPFA Guide to Auditor Panels	Room 128 Shire Hall, Cambridge

## Appendix A – Advantages and Disadvantages of the Auditor Panel Approach

Option	Possible Advantages	Possible Disadvantages
<b>Set up own separate and individual panel to oversee separate and individual procurement</b>	<p>Full ownership of the process</p> <p>Fully bespoke contract with the auditor</p> <p>Tendering process more based on local circumstances (within EU procurement rules)</p>	<p>May experience difficulties in appointing majority independent panel members and independent panel chair as per the regulations</p> <p>Will need to ensure that panel members are suitably qualified to understand and participate in the panel's functions</p> <p>Will have to cover panel expenses</p> <p>May not be able to procure at a lower cost, for example, depending on authority location, where there will be a risk of limited provider choice</p> <p>Would not achieve the desired outcome of a single external auditor across LGSS partners</p>
<b>Set up a panel jointly with other authority/ authorities as part of a procurement exercise for a joint contract covering more than one authority or multiple separate contracts</b>	<p>Less administration than a sole auditor panel</p> <p>Will be able to share the administration expenses</p> <p>May be easier to attract suitable panel members from a broader area</p> <p>If procuring a joint audit contract it will still be a locally tailored process and would also achieve some economies of scale</p> <p>If procuring separate audit contracts there would be an opportunity for fully bespoke contracts with the auditor if the group of authorities can agree</p> <p>Would achieve the desired outcome of a single external auditor across LGSS partners</p>	<p>May need to be an element of compromise for a joint audit contract</p> <p>May not end up with first choice of auditor, compared to an individual auditor panel. If a large group of authorities work together and decide to appoint one joint audit contract across all the authorities, a joint panel may be more likely to advise appointment of an auditor it considers suitable for all authorities taken together. However this is not a disadvantage when compared to the PSAA sector-led approach where the auditors are simply notified.</p> <p>Need to agree appointment of members across multiple authorities and set up an appropriate joint decision-making process</p>

Option	Possible Advantages	Possible Disadvantages
<b>Use existing committee or sub-committee</b>	<p>Existing administrative structure in place</p> <p>Existing (sub)committee should already have a better basic understanding of the authority's objectives and requirements</p>	<p>Possible need to appoint new (sub) committee members to comply with independence regulations</p> <p>May not be appropriate where there is more than one authority due to the embedded context in the organisation within which the Committee already operates.</p>
<b>Use another authority's panel</b>	<p>Will not have to set up an auditor panel</p> <p>Arguably most independent option for the authority using the host authority's panel</p>	<p>The panel may not understand the specific needs and context of the authority</p> <p>May need to enter into a formal arrangement with other authorities</p> <p>May be difficult to find an authority willing to enter into such an arrangement</p> <p>May be more difficult to ensure adequate liaison with the authority's own audit committee</p> <p>Loss of control / input into the process and arrangements</p>