



CORPORATE GOVERNANCE COMMITTEE – 23 SEPTEMBER 2016

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

APPOINTMENT OF EXTERNAL AUDITORS 2018/19 - UPDATE

Purpose of Report

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.
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 for the 2018/19 financial year.

Background

3. 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 for Communities and Local Government (CLG) determined that the transitional arrangements for local government bodies would be extended by one year to include the audit of the accounts for 2017/18.
4. The Council's current external auditor is KPMG, this appointment having been made under a contract let by the Audit Commission in 2015. 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 for CLG. The external audit applies to the County Councils Statement of Accounts and the Leicestershire Pension Fund Accounts.
5. Over recent years local authorities have benefited from a 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. Current fees are also based on discounted rates offered by 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. The Council's current external audit fees are £77,000 per annum for the Statement of Accounts and £28,000 for the Leicestershire Pension Fund.

6. When the current transitional arrangements come to an end on 31 March 2018 the Council will be able to appoint its own local public auditors. There are a number of routes by which this can be achieved, each with varying risks and opportunities.
7. 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.
8. Section 7 of the Local Audit and Accountability Act 2014 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;
9. 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.

Options for the local appointment of External Auditors

10. There are three broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act). These are as follows:

Option 1 - to make a stand-alone appointment

11. In order to make a stand-alone appointment the Council will need to set up an auditor panel consisting of a minimum of three members. The members of the panel must be wholly or a majority of independent members as defined by the Act; this excludes current and former elected members (or officers) and their close family and friends. It will be the responsibility of this panel to assess and choose the firm of accountants that should act as the Council's external auditors and local elected members will have limited involvement in that process.

Advantages/benefit

12. 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.
13. Although limited this option provides the ability for some elected member involvement in the process.

Disadvantages/risks

14. Recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract is estimated by the Local Government Association (LGA) to cost in the order of £15,000 plus on going expenses and allowances
15. The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.

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

16. 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 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 would need to liaise with other local authorities to assess the appetite for such an arrangement.

Advantages/benefits

17. The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
18. 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

19. 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.
20. The choice of auditor could be complicated where individual Councils have independence issues (i.e. it has a conflict of interest). An independence issue occurs where the auditor has recently or is currently carrying out work, such as consultancy or advisory work, for an authority. Where this occurs, some auditors may be prevented from being appointed by the terms of their professional standards to carry out work for one or more of the authorities in the group. There is a risk therefore that the joint auditor panel may chose a firm that cannot carry out audit work for the County Council which would mean that the County Council would then need to make a separate appointment, giving rise to all the attendant costs and loss of economies possible through joint procurement.

Option 3 - Opt-in to a Sector Led Body

21. 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. A 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

22. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities.
23. 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.
24. Any conflicts of interest with individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.
25. The appointment process would not be ceded to locally appointed independent members. Instead a separate body would be 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.

Disadvantages/risks

26. Individual elected members will have no direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.
27. 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.

Risk Management

28. 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.
29. Providing the LGA with a realistic assessment of the County Councils likely way forward, if it agrees to follow Option 3 outlined above, will enable the LGA to invest in developing appropriate arrangements to support the Council.

Financial Implications

30. Current external audit fee levels are likely to increase when the current contracts end in 2018.
31. The cost of establishing a local or joint auditor panel outlined in Options 1 and 2 above will need to be estimated and included in the Council's budget for 2016/17 and 2017/18. This will include the cost of recruiting independent members, servicing the Panel, running a bidding and tender evaluation process, letting a contract and paying members fees and allowances.

32. The costs associated with opting-in to a national SLB (Option 3) would also need to be confirmed following the establishment of a SLB, but such costs are expected to be significantly lower than those associated with Options 1 and 2. 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 the potential to negotiate lower fees. In a recent survey, 58% of respondents expressed an interest in this option, including the County Council. Greatest economies of scale will come from the maximum number of councils acting collectively and opting-in to a SLB.

Next Steps

33. 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 agreed and put in place by spring 2017 in order that the contract negotiation process can be carried out during 2017.
34. The LGA are working on developing a SLB. It has asked the Council for an indication of its preferred approach in order that it can invest resources in providing appropriate support to councils.
35. The legislation requires that a decision to opt-in must be made by full Council and, subject to the comments of this Committee, it is proposed that a report will be taken to the Council meeting on 7th December 2016 recommending this option (Option 3) for approval.

Conclusion

36. It is recommended that Option 3 be pursued as this provides the maximum opportunity to limit the extent of any increases in costs by entering in to a large scale collective procurement arrangement and would remove the costs of having to establish an auditor panel.

Recommendation

37. The Committee is asked to consider the Options set out in this report and to recommend the County Council adopt Option 3 - Opt-in to a Sector Led Body.

Equal Opportunities

38. None.

Circulation Under the Local Issues Alert Procedure

39. None.

Background Papers

40. None.

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