



Audit and Standards Committee Report

Report of: Head of Strategic Finance

Date: 16th November 2016

Subject: Changes to the arrangements for the appointment of External Auditors

Author of Report: Kayleigh Inman, Senior Finance Manager, Internal Audit

Summary:

This report summarises the changes to the arrangements for appointing External Auditors following the closure of the Audit Commission. As requested at the previous meeting, consideration has been given to the costs and benefits of independent procurement and opting into the Sector-Led Body.

Recommendations:

Members are asked to:

1. Support the principle of joining the Public Sector Audit Appointments (PSAA) Limited for the procurement of audit contracts with effect from 2018/19.
 2. Note that a formal decision will be required at a later date which will need Full Council approval.
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Background Papers:

Category of Report: Open

* Delete as appropriate

If Closed, the report/appendix is not for publication because it contains exempt information under Paragraph (insert relevant paragraph number) of Schedule 12A of the Local Government Act 1972 (as amended).'

Statutory and Council Policy Checklist

Financial implications
YES /NO Cleared by: K Inman
Legal implications
YES /NO
Equality of Opportunity implications
YES /NO
Tackling Health Inequalities implications
YES /NO
Human rights implications
YES /NO
Environmental and Sustainability implications
YES /NO
Economic impact
YES /NO
Community safety implications
YES /NO
Human resources implications
YES /NO
Property implications
YES /NO
Area(s) affected
Relevant Scrutiny Committee if decision called in
Not applicable
Is the item a matter which is reserved for approval by the City Council? YES/NO
Press release
YES /NO

Purpose of the 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.
3. At the previous Audit and Standards Committee meeting, members were keen to further explore the costs associated with the option to undertake a local joint procurement exercise with neighbouring authorities/public bodies.

Recommendations

The Committee is asked to:

4. Support the principle of joining the Public Sector Audit Appointments (PSAA) Limited for the procurement of audit contracts with effect from 2018/19.
5. Note that a formal decision will be required at a later date which will need Full Council approval.

Background

6. 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.
7. The Council's current external auditor is KMPG, under a contract managed by Public Sector Audit Appointments Limited (PSAA).
8. Current external audit 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 most NHS and local government bodies and so offered maximum economies of scale. The Council's external audit fee for 2016/17 is £187,000.

9. 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 as 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, so the number of eligible firms is not known, but it is reasonable to expect that the list 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

10. There are three broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act), which were discussed at the Audit and Standards Committee in September. Option 1, procuring our audit individually was rejected, on the grounds that we would want to seek greater economies of scale, and because we co-operate on financial systems and accounts production with the City Region, and so wish to have the same external auditor across several bodies. Members were however keen to explore the following options further in this report:

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

Option 3 Opt-in to a sector led body

Option 2

11. The Act enables the Council to join with other authorities to establish a joint auditor panel. The panel must be wholly or a majority 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.
12. Further legal advice will be required on the exact constitution of such a panel if a joint procurement exercise is undertaken, having regard to the obligations of each body involved.
13. Following consultation with the South and West Yorkshire Authorities, to date, only Doncaster and Kirklees expressed any interest in being involved in joint procurement exercise. Both have provisionally opted into the Sector Led Body but are not wedded to that option and would consider the use of a joint auditor panel, if enough regional local authorities opted-in. Kirklees suggested that they may prefer to conduct their own tendering exercise and then use the joint panel to evaluate and select the preferred bidder.
14. The Sheffield City Region (SCR) discussed the issue at the Director of Finance level and was more in favour of opting into the Sector Led Body. The Passenger Transport Executive (PTE) is also likely to opt for this approach.

15. At this stage, therefore there is no significant appetite to conduct a joint procurement exercise.

Costs

16. 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.
17. By way of 'soft-market testing', Commercial Services provided the schedule of rates attached to the Crown Commercial Service (CCS) framework. This framework is essentially a government approved list of providers who can undertake work for the public sector under various 'lots'. There are 9 providers of external audit work on the framework, and so this is representative of the firms who are likely to be eligible to bid for our contract. Simple benchmarking against the published rates indicates that there is little scope for a large reduction in audit fees by procuring directly.

Advantages/benefits

- a) The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities. However, with the low levels of interest, and the suggestion from Kirklees to simply share the auditor panel, this may not reduce procurements costs significantly.
- b) There is an opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms, although this again will be affected by the low levels of interest from neighbouring authorities.

Disadvantages/risks

- a) 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.
- b) There will be significant costs and time involved both in setting up and remunerating the auditor panel, and in running the procurement process. The LGA estimate costs in the order of £15,000 plus on going expenses and allowances.

- c) 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 a 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

- 18. PSAA have been approved by DCLG to be a sector-led body for principal authorities (councils, police and fire bodies). The role of the PSAA will be to procure contracts for external audit and then allocate the successful providers to the bodies who have opted in.
- 19. 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. This approach is very similar to the current arrangements for appointing external audit.
- 20. It is too early to estimate the new audit fee with effect from 2018/19 but the cost will almost certainly be lower through a sector-led procurement than local procurement. The prospectus issued by the PSAA is attached at appendix 1.

Advantages/benefits

- a) The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities. The PSAA is a not-for-profit organisation and any surplus funds will be returned to scheme members. Its creation is strongly supported by the Local Government Association.
- b) 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.
- c) Any conflicts at individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.
- d) The appointment process would not be made by locally appointed independent members. Instead a separate body, set up to act in the collective interests of the 'opt-in' authorities, would do this. The appointment of the external auditors is therefore independent of the auditees, greatly increasing the transparency of the auditor's independence.
- e) There is no requirement for an independent auditor panel.

- f) The PSAA have committed, where possible, to allocate the same auditors to bodies involved in significant collaboration or joint working initiatives or combined authorities, if the parties believe that it will enhance efficiency and value for money.
- g) PSAA have a stated aim to manage the market for external audit procurement, ensuring that sufficient players remain within the market to allow proper choice and competition for future contracts. A piecemeal approach by individual bodies risks either fragmenting the market, leading to a loss of quality, or creating a dominant player, reducing choice and increasing prices at future tenders.

Disadvantages/risks

- a) Individual elected members will have less opportunity for direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.
- b) The PSAA will continue to consult scheme members with any proposals, however they are not able to consult on the proposed scale of fees until the initial major procurement has been completed and contracts with audit firms have been let. This is not dissimilar to the situation that would arise if the independent procurement approach was adopted, in that prices will not be known until the tendering exercise has been carried out.

Financial Implications

- 21. The cost of establishing a local or joint Auditor Panel outlined in option 2 above will need to be included in the Council's budget for 2017/18. This will 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. As stated above the LGA estimate costs in the order of £15,000 plus on going expenses and allowances.
- 22. Opting-in to a national SLB provides maximum opportunity to limit the extent of any fee increases by entering in to a large scale collective procurement arrangement and would remove the costs of establishing an auditor panel.
- 23. Current external fees levels are likely to increase when the current contracts end in 2018. Until either procurement exercise is completed it is not possible to state what additional resource may be required for audit fees for 2018/19, although it is anticipated that any increase will be minimised through using PSAA.

Conclusion and Recommendations

24. Given the limited appetite amongst local public bodies to undertake joint procurement and the likely costs associated with such an exercise, coupled with limited scope for fee reductions, it is recommended that the Audit and Standards Committee support the principle of joining the Public Sector Audit Appointments (PSAA) Limited for the procurement of audit contracts with effect from 2018/19.