

AUDIT COMMITTEE REPORT

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OPEN	

Committee: Audit Committee

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Subject: Changes to arrangements for appointment of External Auditors

Summary

This report summarises 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.

The decision will have to be made by Full Council in accordance with Schedule 3, Local Audit and Accountability Act 2014 and arrangements will need to be implemented in time to make a first appointment by 31 December 2017.

Recommendation

Members are requested to recommend their preferred approach of either:

1. Establishing a stand-alone Auditor Panel to advise the Council on the appointment on behalf of the Council.
2. Commencing work on exploring the establishment of local joint procurement arrangements with neighbouring authorities
3. Indicate the intention to “opt-in” to the procurement process by Public Sector Audit Appointments Ltd (PSAA), as the national Sector Led Body (SLB) (this is the preferred option).
4. Do nothing, in which case an auditor will be appointed by the Secretary of State (this is not recommended).

1. Background to the issue

- 1.1. The Local Audit and Accountability Act 2014 brought to a close the Audit Commission and established PSAA to manage the transitional arrangements for the appointment of external auditors and the setting of audit fees for local government. These transitional arrangements have been extended by one year to also include the audit of the accounts for 2017/18.
- 1.2. The Council's current external auditor is Ernst & Young, who were appointed for the audit year 2012/13. The final year of audit under the existing arrangement is 2016/17. When the current transitional arrangements come to an end on 31 March 2018 the Council will need to have a new auditor in place. There are a number of routes by which this can be achieved, each with varying risks and opportunities.
- 1.3. 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 the Institute of Chartered Accounts for England and Wales (ICAEW) who are the Registered Supervising Body approved by the Financial Reporting Council. It is unlikely that small local independent firms will meet the eligibility criteria. Those accounting firms currently approved are listed in **Appendix A**.
- 1.4. Previous external audit contracts have included Grant Certification work that audits the benefits administered on behalf of the Department for Work and Pensions (DWP). The new contracts will only cover the audit of the accounts. Arrangements for the Grant Certification work are being developed by DWP with the support of PSAA.

2. Options for local appointment of External Auditors

- 2.1. There are four broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act). The advantages and disadvantages have been summarised in a table in **Appendix B**.

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

In order to make a stand-alone appointment the Council will need to set up an Auditor Panel. The members of the panel must consist wholly, or a majority, of independent members as defined by the Act and the Chair must also be independent.

Appendix C provides details of the onerous independence requirements, although no definition of 'friend' is provided.

Appendix D is an extract from the 'Guide to Auditor Panels' published by CIPFA, indicating the knowledge and experience independent members will need to be able to fulfil the role.

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

The Act enables the Council to join with other authorities to establish a joint auditor panel (e.g. across all Norfolk councils). Again this will need to consist wholly, or a majority, of independent members.

The Assistant Director (s151 Officer) has recently attended the Norfolk Finance Officers meeting and established that there is no appetite for a Norfolk-wide Auditor Panel. It is expected that the SLB will be used by the other councils.

2.4. Option 3 - Opt-in to a sector led body (SLB)

On 22nd July 2016 PSAA was specified by the Government to become the SLB authorised to make future audit appointments on behalf of principal local authorities.

An 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. In a recent survey, 58% of local authority respondents expressed an interest in the SLB option.

2.5 Option 4 - Do Nothing (Not recommended)

If the Council fails to appoint an auditor by December 2017, the Secretary of State has the power to appoint a local auditor. This is not a recommended course of action.

3. Conclusion and Next Steps

3.1. There are 3 key points for Members to note:

- i. Whichever option is chosen, this Committee will not be involved in the selection procedure.
- ii. It is unlikely that local audit firms will be eligible to tender.
- iii. The eligible firms have indicated that they will not be interested in small individual contracts.

3.2. If option 3 is selected, a formal decision to opt-in will be required by January 2017 to enable the PSAA to realistically tender to obtain the maximum buying power.

3.3. If options 1 or 2 are selected, the panel recruitment will need to be initiated to be in place by spring 2017, in order that the contract negotiation process can be carried out to make the appointment by December 2017.

4. Policy Implications

There are no policy implications

5. Financial Implications

5.1. If option 1 or 2 is approved, the cost of establishing a local or joint Auditor Panel outlined above will need to be estimated and included in the Council's budget for 2016/17 and 2017/18.

5.2. Opting-in to the national SLB provides maximum opportunity to limit the extent of any increases by entering in to a large scale collective procurement arrangement and would remove the costs of establishing an auditor panel. PSAA will apply a charge to cover the cost of the procurement process, but this will be shared by all the participating local authorities and any surplus funds would be returned to the participants.

6. Personnel Implications

There are no personnel implications

7. Statutory Considerations

7.1. Local Audit and Accountability Act 2014:

Sec 7 – a local authority must appoint an auditor no later than December of the preceding year

Sec 8 – governs the procedure to appoint and specifies that the Full Council must appoint.

Sec 12 – where a local authority fails to appoint an auditor, the Secretary of State will appoint one.

Sec 17 - gives the Secretary of State the ability to enable a Sector Led Body (SLB) to become the appointing person.

8. Equality Impact Assessment (EIA)

There are no equality implications.

9. Risk Management Implications

9.1. 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.

10. Declarations of Interest / Dispensations Granted

None required.

11. Supporting Information

The following web links provide Members with useful guidance and information:

CIPFA 'Guide to Auditor Panels'

<http://www.cipfa.org/policy-and-guidance/publications/g/guide-to-auditor-panels-pdf>

PSAA Corporate Plan 2015-18

<http://www.psa.co.uk/about-us/what-we-do/corporate-plan-2015-2018/>

Local Audit and Accountability Act 2014

<http://www.legislation.gov.uk/ukpga/2014/2/contents>

Accounting firms approved for public audit.

The following firms have been approved by ICAEW as eligible for appointment as local auditors:

- BDO LLP
- Deloitte LLP
- Mazars LLP
- Ernst & Young LLP
- PricewaterhouseCoopers LLP
- KPMG LLP
- Grant Thornton UK LLP
- Scott Moncrieff
- Moore Stephens LLP

List correct as at 26th July 2016.

Advantages and disadvantages of the various options

ADVANTAGES/ BENEFITS	DISADVANTAGES/ RISKS
Option 1 - To make a stand-alone appointment	
<p>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, although the choice will be heavily restricted by the requirement for auditors to register with the ICAEW and so the contract may not be open to local firms.</p>	<p>The Council might not receive any bids if the contract is seen to be too small. Audit firms have already indicated that they would not be interested in small individual contracts.</p>
	<p>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</p>
	<p>The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.</p>
	<p>The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by elected members.</p>
	<p>The relationship with the Audit Committee will need to be managed to ensure a good working relationship is established and managed as the Audit Committee will be receiving and commenting on work carried out by the external auditors selected by the auditor panel.</p>
	<p>The Auditor Panel would need to monitor the contract and ensure the quality of the auditors work was satisfactory using a range of performance metrics. This role is currently performed by PSAA.</p>

Advantages and disadvantages of the various options

ADVANTAGES/ BENEFITS	DISADVANTAGES/ RISKS
	<p>It is possible that resources are spent unsuccessfully if the Panel is appointed but the Council fails to attract sufficient bids or award a contract. In the instance that an auditor is not appointed, the Secretary of State will appoint one (see the 'Do nothing' option).</p>
	<p>The process may be perceived by members of the public and other stakeholders, as the council appointing its own auditors and therefore lacking independence.</p>
Option 2 - Set up a Joint Auditor Panel/ local joint procurement arrangements	
<p>The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.</p>	<p>The choice of auditor could be complicated where the auditor has recently or is currently carrying out work such as consultancy or advisory work for the 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.</p>
<p>There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.</p>	<p>The value of a contract covering several councils would require the OJEU process to be followed, increasing the length of time required for the procurement process.</p>
	<p>The independence criteria will still apply to members of the panel and in fact could be exacerbated by the involvement of more councils. Any member of the panel would need to satisfy the independence criteria in relation to all the councils</p>

Advantages and disadvantages of the various options

ADVANTAGES/ BENEFITS	DISADVANTAGES/ RISKS
	involved.
	As with the stand-alone panel discussed above, the Joint Auditor Panel would need to monitor the contract and ensure the quality of the auditors work was satisfactory using a range of performance metrics. This role is currently performed by PSAA.
	An additional complication with the Joint Auditor Panel and letting one contract for several councils may arise if one council or more councils have concerns with the audit service, and others do not.
Option 3 - Opt-in to a sector led body	
The costs of setting up appointment panels and negotiating fees would be shared across all opt-in authorities.	Individual elected members will have less opportunity for direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.
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	PSAA will apply a charge to cover the cost of the procurement process, but this will be shared by all the participating local authorities and any surplus funds would be returned to the participants.
Any conflicts of interests at individual authorities would be managed by PSAA who would have a number of contracted firms to call upon.	
The appointment process would not be ceded to locally appointed independent members. Instead PSAA would act in the collective interests of the 'opt-in' authorities, utilising the knowledge and experience acquired through the transitional arrangements	

Advantages and disadvantages of the various options

ADVANTAGES/ BENEFITS	DISADVANTAGES/ RISKS
<p>PSAA would take on the role of managing quality assurance and arbitration/ dispute resolution.</p>	
<p>The process could be seen by members of the public and other stakeholders to be more independent and transparent than using a locally appointed panel.</p>	
Option 4 - Do nothing	
<p>No costs of setting up Appointment Panel or procurement exercise.</p>	<p>There will be no opportunity to benefit from economies of scale.</p>
	<p>The Secretary of State will have to appoint and the Council may be seen to be not taking a proactive approach to managing its financial arrangements, which could impact on its reputation.</p>

Independence Criteria**Extract from the Local Audit and Accountability Act 2014 (including amendments made by regulations)****Local Audit and Accountability Act 2014****SCHEDULE 4 Further provisions about auditor panels****Constitution of auditor panels**

2(1)A relevant authority's auditor panel, other than a health service body's auditor panel—
 (a) must consist of a majority of independent members (or wholly of independent members),
 and

(b) must be chaired by an independent member.

(2)A member of a relevant authority's auditor panel, other than a health service body's auditor panel, is "independent" at any given time if the following conditions are met—

(a) the panel member has not been a member or officer of the authority within the period of 5 years ending with that time (the "last 5 years"),

(b) the panel member has not, within the last 5 years, been a member or officer of another relevant authority that is (at the given time) connected with the authority or with which (at the given time) the authority is connected,

(c) the panel member has not, within the last 5 years, been an officer or employee of an entity, other than a relevant authority, that is (at the given time) connected with the authority,

(d) the panel member is not a relative or close friend of—

(i) a member or officer of the authority,

(ii) a member or officer of another relevant authority that is connected with the authority or with which the authority is connected, or

(iii) an officer or employee of an entity, other than a relevant authority, that is connected with the authority,

(e) the panel member is not the authority's elected mayor,

(f) neither the panel member, nor any body in which the panel member has a beneficial interest, has entered into a contract with the authority—

(i) under which goods or services are to be provided or works are to be executed,
 and

(ii) which has not been fully discharged,

(g) the panel member is not a current or prospective auditor of the authority, and

(h) the panel member has not, within the last 5 years, been—

(i) an employee of a person who is (at the given time) a current or prospective auditor of the authority,

(ii) a partner in a firm that is (at the given time) a current or prospective auditor of the authority, or

(iii) a director of a body corporate that is (at the given time) a current or prospective auditor of the authority.]

(7)In sub-paragraph (2)—

- "elected mayor" has the same meaning as in Part 1A of the Local Government Act 2000;

- "officer", in relation to an entity other than a relevant authority, means a person elected or appointed as, or to, that entity.]

(8)For the purposes of sub-paragraph (2)(d)], a person ("R") is a relative of another person ("P") if R is—

(a) P's partner,

(b) P's parent or grandparent,

(c) P's son, daughter, stepson, stepdaughter or grandchild,

(d) P's brother or sister,

Independence Criteria

Extract from the Local Audit and Accountability Act 2014 (including amendments made by regulations)

(e) P's uncle, aunt, nephew or niece,

(f) a parent, son, daughter, brother or sister of P's partner, or

(g) a partner of any person within paragraphs (b) to (f),

and for this purpose "partner" means a spouse, civil partner or someone a person lives with as if they were husband and wife or civil partners.

(8A) For the purposes of sub-paragraph (2)(f) to (h)—

- "body in which the panel member has a beneficial interest" means a body in which the panel member is a partner, or of which the panel member is a director, or in the securities of which the panel member has a beneficial interest;
- "current or prospective auditor", in relation to a relevant authority, means—

(a) the person appointed to act as the authority's local auditor, or

(b) a person who has made a bid, which has not been declined or withdrawn, for a contract of appointment as the authority's local auditor;

- "director" includes a member of the management committee or other directing body of a registered society, and a member of a limited liability partnership;
- "registered society" means a registered society within the meaning of the Co-operative and Community Benefit Societies Act 2014;
- "securities" means shares, debentures, debenture stock, loan stock, bonds, units of a collective investment scheme within the meaning of the Financial Services and Markets Act 2000 and other securities of any description, other than money deposited with a building society.]

(9) The Secretary of State may by regulations amend this paragraph so as to make provision about the members of a relevant authority's auditor panel who are or are not independent for the purposes of sub-paragraph (1).

KNOWLEDGE AND EXPERIENCE

- 3.15 An effective panel composition not only takes into account the independence of its members, but also considers their skills and abilities. There is a wide range of knowledge and experience that members can bring to a panel and that will enable it to perform effectively. No one panel member would be expected to be an expert in all areas, but there may be some core areas of knowledge that members will need to acquire.
- 3.16 In addition, there are also specific skills that the panel chair will need. Many of these skills are not unique to the role of auditor panel chair and experience in other positions or non-executive roles should have helped to build these skills.
- 3.17 Evidence of appropriate skills and knowledge should be sought when appointing members to the panel, particularly for independent members whose skills may not already be known to the authority.
- 3.18 The following list sets out some key areas in which at least some general knowledge and experience will be desirable in a panel member:
- a. local authority finance
 - b. accountancy (public sector or commercial)
 - c. audit processes and regulation (public or private sector, external/local audit or internal audit), including more specifically,
 - d. the role and responsibilities (statutory duties) of a local public auditor in local government.
- 3.19 Other useful knowledge and experience may include knowledge of the authority itself; local government governance arrangements; the role and operation of the auditor panel; procurement; values of good governance and ethics; and law.
- 3.20 Authorities can tailor these lists to their own local circumstances. They may also wish to distinguish between core areas of knowledge that all panel members should seek to acquire and a range of specialisms that can add value to the panel.