

# Gloucester City Council

<b>Meeting:</b>	<b>Audit and Governance Committee</b>	<b>Date:</b>	<b>19<sup>th</sup> September 2016</b>
	<b>Council</b>		<b>1 December 2016</b>
<b>Subject:</b>	<b>Changes to the arrangements for appointment of External Auditors</b>		
<b>Report Of:</b>	<b>Head of Finance (Section 151 Officer)</b>		
<b>Wards Affected:</b>	<b>Not applicable</b>		
<b>Key Decision:</b>	<b>No</b>	<b>Budget/Policy Framework:</b>	<b>No</b>
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<b>Appendices:</b>	<b>None</b>		

## FOR GENERAL RELEASE

### 1.0 Purpose of Report

- 1.1 To summarise 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 external audits.
- 1.2 To outline options for the appointment of the Council's External Auditor for the 2018/19 statement of accounts and enable the Committee to recommend to Council the preferred appointment process.

### 2.0 Recommendations

- 2.1 **Audit and Governance Committee** is asked to **RESOLVE** to endorse and **RECOMMEND** to Council the option to opt-in to the Public Sector Audit Appointments Ltd (PSAA) as the Sector Led Body (SLB) for the appointment of the Council's External Auditors from 2018/19.
- 2.2 **Council** is asked to **RESOLVE** to opt-in to the PSAA as the SLB for the appointment of the Council's External Auditors from 2018/19.

### 3.0 Background and Key Issues

#### Background

- 3.1 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<sup>th</sup> 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 also include the audit of the accounts for 2017/18.

- 3.2 The Council's current External Auditor is KPMG LLP, this appointment having been made under a contract let by the Audit Commission. Following closure of the Audit Commission the contract is currently managed by PSAA, the transitional body set up by the LGA with delegated authority from the Secretary of State CLG. Over recent years there have been significant reductions 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, savings from closure of the Audit Commission and Council led improvements to internal year end processes and controls. The indicative scale fee for the audit of Gloucester City Council is £63,450 for both 2015/16 and 2016/17, which is a reduction in audit fee of 25% when compared to the 2014/15 audit fee of £84,600. In addition, the fee for the certification of claims and returns is approximately £12,500.
- 3.3 When the current transitional arrangements come to an end on 31<sup>st</sup> March 2018 the Council will be able to move to local appointment of the auditor. There are a number of routes by which this can be achieved, each with varying risks and opportunities. Current 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 NHS and local government bodies and offered maximum economies of scale.
- 3.4 The scope of the external 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.
- 3.5 There are three broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act) and the Council have until December 2017 to make an appointment. The preferred option, based on consideration of the advantages and risks, is as follows:
- 3.6 Preferred option: Opt-in to a SLB
- 3.6.1 In response to the consultation on the new arrangement the LGA successfully lobbied for Councils to be able to 'opt-in' to a 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. At this stage, the length of such contracts has yet to be determined. However, the audit contracts between the SLB and the audit firms will require firms to deliver audits compliant with the NAO Code of Audit Practice.

### 3.6.2 *Advantages/benefits:*

- a. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities, thus minimising the cost to each individual authority.
- 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 ceded to locally appointed independent members. Instead a separate body is set up to act in the collective interests of the 'opt-in' authorities.

### 3.6.3 *Disadvantages/risks:*

- e. Individual elected Members will have less opportunity for direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.
- f. 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.

3.6.4 The LGA have been working on developing a SLB arrangement, with around 270 councils and local bodies who expressed initial interest in a national scheme.

3.6.5 In late July 2016 under the Local Audit (Appointing Person) Regulations 2015, the DCLG approved PSAA's bid to become the SLB for the independent appointment of auditors for principal authorities in England beginning with responsibilities for the financial year 2018/19.

## **4.0 Asset Based Community Development (ABCD) Considerations**

4.1 There are no ABCD implications as a result of the recommendation made in this report.

## **5.0 Alternative Options Considered**

5.1 The remaining two options open to the Council under the Act are not recommended as the preferred option, due to their associated disadvantages and costs.

### **5.2 Alternative option 1: To make a stand-alone appointment**

5.2.1 In order to make a stand-alone appointment the Council will need to set up an auditor panel. The panel membership 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. This means that elected Members will not have a majority input to assessing bids and choosing which firm of accountants

to award a contract for the Council's external audit. A new independent auditor panel established by the Council will be responsible for selecting the auditor.

#### 5.2.2 *Advantages/benefit:*

- a. 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.

#### 5.2.3 *Disadvantages/risks:*

- b. Recruitment and servicing of the auditor panel, running the bidding exercise and negotiating the contract are estimated by the LGA to cost in the order of £15,000 plus ongoing expenses and allowances.
- c. The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts, and is therefore likely to end up paying significantly higher fees.
- d. The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by elected Members.

### 5.3 Alternative option 2: Local joint procurement arrangements

5.3.1 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 appointees. 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 need to liaise with other local authorities to assess the appetite for such an arrangement.

#### 5.3.2 *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.
- b. There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.

#### 5.3.3 *Disadvantages/risks:*

- c. 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 possibly only one elected Member representing each Council, depending on the constitution agreed with the other bodies involved.

- d. 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 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.
- e. Even if the Council joins with one or more other local authorities, it will still not be able to offer the scale of appointment that would be available on a nationwide process. It would therefore be likely to incur higher fees than the preferred option detailed in paragraph 3.6.

## **6.0 Reasons for Recommendations**

- 6.1 Opting-in to PSAA's national SLB potentially provides the best opportunity to limit future fees or costs, in terms of both appointment of auditors (removing the need to establish a local auditor panel) and the audit (by entering into a large scale collective procurement arrangement).
- 6.2 The LGA has continuously supported the SLB approach, believing it will offer best value to Councils by reducing set-up costs and having the potential to negotiate lowest possible fees.
- 6.3 It is recommended that the Committee endorses the preferred option (detailed within paragraph 3.6) for the appointment of External Auditors and recommends to Council to opt-in to the PSAA as the SLB for the appointment of the Council's External Auditors from 2018/19.

## **7.0 Future Work and Conclusions**

- 7.1 The Council has until December 2017 to make an appointment. In order that more detailed proposals can be developed the Committee is asked to give early consideration to the preferred approach and make a recommendation to Full Council.
- 7.2 The Council has been asked by the LGA for an indication of the preferred approach in order that it can invest resources in providing appropriate support to Councils.

## **8.0 Financial Implications**

- 8.1 The LGA considers that current external fees levels are likely to increase when the current contracts end in 2018.
- 8.2 The cost of establishing a local or joint auditor panel (a requirement of the section 5 alternative options) would include:
  - The cost of recruiting independent appointees (members);
  - Servicing the panel;
  - Running a bidding and tender evaluation process;

- Letting a contract; and
- Paying panel members' fees and allowances.

These costs are not currently reflected within the Council's budget.

- 8.3 Opting-in to a 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.

(Financial Services have been consulted in the preparation this report).

## **9.0 Legal Implications**

- 9.1 Section 7 of the Local Audit and Accountability Act 2014 (the Act) requires a relevant authority to appoint a local auditor to audit its accounts for a financial year not later than 31<sup>st</sup> 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.

- 9.2 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.

- 9.3 Section 17 gives the Secretary of State the power to make regulations in relation to an 'appointing person' specified by the Secretary of State.

- 9.4 The Local Audit (Appointing Person) Regulations 2015 (SI 192) gives the Secretary of State the ability to enable a SLB to become the appointing person and confirms the decision to opt-in must be made by the authority meeting as a whole (i.e. Full Council).

(One Legal have been consulted in the preparation this report).

## **10.0 Risk and Opportunity Management Implications**

- 10.1 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.

- 10.2 Providing the LGA with a realistic assessment of the Council's likely way forward will enable the LGA to invest in developing appropriate arrangements to support the Council.

## **11.0 People Impact Assessment (PIA):**

- 11.1 The PIA Screening Stage was completed and did not identify any potential or actual negative impact, therefore a full PIA was not required.

## **12.0 Other Corporate Implications**

### Community Safety

- 12.1 There are no 'Community Safety' implications arising out of the recommendations in this report.

### Sustainability

- 12.2 There are no 'Sustainability' implications arising out of the recommendations in this report.

### Staffing & Trade Union

- 12.3 There are no 'Staffing and Trade Union' implications arising out of the recommendations in this report.

**Background Documents:** The Local Audit and Accountability Act 2014  
LGA generic report on External Auditor appointments