

DERBYSHIRE COUNTY COUNCIL**AUDIT COMMITTEE MEETING****10 May 2016****Report of the Director of Finance, Director of Legal Services and Assistant
Director of Finance (Audit)****APPOINTMENT OF EXTERNAL AUDITOR****1. Purpose of Report**

To inform Members of changes to the arrangements for appointing external auditors following the closure of the Audit Commission, the end of the transitional arrangements at the conclusion of the 2017/18 audits and the need to consider options available and put in place new arrangements in time to make a first appointment by 31 December 2017.

2. Information and Analysis

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 the Department of Communities and Local Government (DCLG) 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.

The Council's current external auditor is KPMG, 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 Public Sector Audit Appointments Limited (PSAA), the transitional body set up by the Local Government Association (LGA) with delegated authority from the DCLG. During recent years the Council has benefited from a reduction in fees 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 the closure of the Audit Commission. The Council's external audit fee for 2015-16 is £125,356 and £28,672 for the Pension Fund.

When the current transitional arrangements come to an end on 31 March 2018 the Council will be able to move to local appointment of its external 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.

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 therefore 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.

At this Committee's meeting on 3rd February 2015 Members were provided with details regarding the DCLG publication "Future of Local Audit – Consultation on Secondary Legislation: Summary of Responses and the Government Response" incorporating the DCLG's response to those sections of the Consultation to which the Council responded.

Options for local appointment of External Auditors

There are three broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act):

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 be wholly or a majority of independent members as defined by the Act. Independent members for this purpose are independent appointees, this excludes current and former Members (or officers) and their close families and friends. This means that 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.

Advantages/benefits

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.

Disadvantages/risks

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.

The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.

The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by Members.

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. 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.

Advantages/benefits

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

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

The decision making body will be further removed from local input, with potentially no input from Members where a wholly independent Panel is used or possible only one Member representing each Council, depending on the constitution agreed with the other bodies involved.

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 that 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 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 - Opt-in to a sector led body

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. 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.

Advantages/benefits

The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities.

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.

Any conflicts at individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.

A separate body would be established 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

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

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.

The Way Forward

The Council have until December 2017 to make an appointment. In practical terms this means that one of the options outlined in this report will need to be in place by spring 2017 in order that the contract negotiation process can be carried out during 2017.

The LGA are working on developing a SLB. In a recent survey, 58% of respondents expressed an interest in this option. Greatest economies of scale will come from the maximum number of councils acting collectively and opting-in to a SLB.

Cabinet is due to consider this matter at its meeting on the 24th May 2016 at which Members will be asked to consider the options and support an indicative response to the LGA that we wish to be part of a SLB. A final decision will be made later in the year when the form of the SLB is clearer.

3. Financial Considerations

External audit fees are likely to rise when current contracts end in 2018.

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. This will include the cost of recruiting independent appointees, servicing the Panel, operating a bidding and tender evaluation process, letting a contract and paying fees and allowances.

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.

4. Legal Considerations

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 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 12 makes provision for the failure to appoint a local auditor. In this event 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.

Section 17 gives the Secretary of State the power to make regulations in relation to an 'appointing person' specified by the Secretary of State. This power has been exercised in the Local Audit (Appointing Person) Regulations 2015 (SI 192) and this gives the Secretary of State the ability to enable a Sector Led Body to become the appointing person.

5. Other Considerations

In preparing this report the relevance of the following factors has been considered: prevention of crime and disorder, equality and diversity, human resources, health, environmental, property and transport considerations.

6. Officers' Recommendation

Members are requested to note the content of this Report.

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