

Agenda Item No 7(d)

DERBYSHIRE COUNTY COUNCIL

CABINET

24 May 2016

Report of the Director of Finance

**CHANGES TO ARRANGEMENTS FOR APPOINTMENT OF EXTERNAL
AUDITORS**

(STRATEGIC POLICY, BUDGET AND ECONOMIC DEVELOPMENT)

1 Purpose of the Report

To inform Cabinet of 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 Information and Analysis

Background to the issue

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 will 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 Secretary of State CLG. Over recent years local authorities have benefited from 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 and savings from closure of the Audit Commission. The Council's external audit fees for 2015-16 are approximately £0.150m.

When the current transitional arrangements come to an end on 31 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.

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 the Council's current auditor. It is unlikely that small local independent firms will meet the eligibility criteria.

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 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 (assuming there is no existing independent committee such as the Audit Committee that might already be suitably constituted).

Advantages/benefit

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 tendering 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 elected 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 (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 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 tendering 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 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.

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.

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 will 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 will be shared across all opt-in authorities.

By offering large contract values the firms will be able to offer better rates and lower fees than are likely to result from local negotiation.

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

The appointment process will not be ceded to locally appointed independent members. Instead a separate body 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

Individual elected 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 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.

There has been discussion at officer level, amongst the larger public bodies affected, to determine whether there is appetite for running a joint procurement that will include the eight Derbyshire districts/boroughs, Derbyshire County Council, Derby City Council, Peak District National Park Authority, the Office of the Police and Crime Commissioner and the Derbyshire Fire and Rescue Service. However, whilst this was seen as a viable alternative all felt that there were significant benefits from joining a larger scale procurement exercise.

The LGA are working on developing a Sector Led Body (SLB) to undertake the procurement of external auditors on behalf of all local authorities. 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. In order to strengthen the LGA's negotiating

position and enable it to more accurately evaluate the offering, the Council is asked to consider whether it is interested in the option of opting in to a SLB. A formal decision to opt-in will be required at a later stage.

Risk Management

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.

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

Next Steps

The Council will need to take action to implement new arrangements for the appointment of external auditors from April 2018. In order that more detailed proposals can be developed the Council is asked to give early consideration to the preferred approach.

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. 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 the lowest fees.

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. PSAA intend to let contracts by mid-2017 to leave up to six months to establish the optimum distribution of appointments, taking into account such issues as independence, firms centres of excellence or geographic hubs.

A further report will be submitted to Cabinet on the preferred approach later in the year.

3 Financial Considerations

Current external fees levels could increase when the current contracts end in 2018. The Council has benefitted greatly from economies of scale achieved as part of the national procurement process that led to the appointment of our current external auditor.

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 appointees (members), servicing the Panel, running a tendering exercise, including an evaluation process, letting a contract and paying members 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 will 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 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;

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.

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:- human rights, equality of opportunity, health, environmental, transport, property and crime and disorder considerations.

6 Background Papers

Papers held in Technical Section, Corporate Finance, Room 137.

7 Key Decision?

No.

8 Is it necessary to waive the call-in period?

No.

9 Officer's Recommendations

That Cabinet notes:

- (i) the changes to the arrangements for appointing External Auditors at the conclusion of the 2017-18 audit; and
- (ii) the Council's support of the LGA's sector led body approach.

PETER HANDFORD

Director of Finance