

Report to Audit committee
20 September 2016
Report of Chief internal auditor, LGSS
Subject External audit appointment

Item
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Purpose

There is a statutory requirement for the council's Statement of Accounts to be independently audited. The Local Audit and Accountability Act 2014 brings changes to the appointment process for external auditors (referred to in the Act as a local auditor).

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.

The contract for the present external auditors, Ernst & Young LLP (EY), is due to expire 31 March 2018. The council must, by 31 December 2017, has appointed, or re-appointed, a local auditor to be in place by April 2018, to undertake the audit of the council's financial statements for 2018-19 onwards.

Recommendation

The audit committee recommend to cabinet that Option (3) – Sector Led Appointment be progressed.

Corporate and service priorities

The report helps to meet the corporate priority "Value for money services".

Financial implications

None directly.

Ward/s: All wards

Cabinet member: Councillor Stonard – Resources and business liaison

Contact officers

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Background documents

None

Report

Background

1. The Local Audit and Accountability Act 2014 closed the Audit Commission and established transitional arrangements for the appointment of external auditors and the setting of audit fees for councils.
2. 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.
3. The council's current external auditor is Ernst & Young LLP (EY). 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.
4. 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.
5. The Act requires that a relevant authority, i.e. Norwich City Council, '...consult and take in to account advice from its audit panel when selecting and appointing a local auditor', i.e. the external auditor.
6. An audit panel established under the Act must be appointed by the council, or by the council and one or more other relevant authorities. The Act also requires that the audit panel must consist of a **majority** of independent members, or wholly of independent members, **including the Chair**. An existing committee, or sub-committee, or panel, can be appointed to act as an audit panel if they comply with the above requirements of the Act. However, the requirement for a majority of independent members means that existing committees are unlikely to meet the requirements for councils. Alternatively, Public Sector Audit Appointments Ltd (PSAA) has now been specified as the sector-led appointing body under the Local Audit (Appointing Person) Regulations 2015.
7. Current 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 NHS and local government bodies and offered maximum economies of scale.
8. The scope of the audit will continue to 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.

Options

9. Essentially there are 3 options permitted under the 2014 Act:

- Option 1 – to make a stand-alone appointment
- Option 2 – joint appointment via joint audit panel
- Option 3 – opt-in to a 'sector led' appointment body (Recommended)

Option (1) – Stand Alone

10. In order to make a stand-alone appointment the council will need to set up an Auditor Panel which must consist of at least a majority of independent members, and must be chaired by an independent member.
11. Independent members for this purpose are independent appointees, this excludes current and former elected members (or officers) and their close families and friends.
12. The panel is created in order to facilitate the appointment of the external auditor, and also:
 - advises the council on maintaining an independent relationship with its auditor
 - must publish its advice to the council
 - must be provided any information held by the authority that is of relevance to the auditor panel's work upon request
 - should be served by a member or officer of the council and can require members / officers to attend to provide information / answer questions.
13. The council must consult its auditor panel and take its views into account when selecting and appointing an auditor.
14. For local authorities operating executive arrangements the appointment of the auditor must be undertaken by full council and not the executive.
15. The council must publish a notice within 28 days of making the appointment that: states it has made the appointment; the term of that appointment; who the appointed auditor is; sets out the auditor panel's advice; and if that advice has not been followed, the relevant authority's reasons for not following it.
16. The constitution of an audit panel means that councillors will not have the majority input to assessing bids and choosing which firm of accountants to award a contract for the council's external audit.

Advantages

17. 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

18. 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 ongoing expenses and allowances.
19. The council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts. Albeit possible that individual procurement may result in a reduced fee it is considered more likely that fees would be higher than current levels through this route.

Option (2) - Set up a Joint Auditor Panel

20. The Act enables the council to join with other authorities to establish a joint auditor panel. As with option (1) 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 would need to liaise with other local authorities to assess the appetite for such an arrangement.
21. Such joint arrangements could be progressed:
 - Through existing regional / geographic partnerships e.g. a Local Enterprise Partnership or Norfolk councils.
 - With LGSS partners (i.e. with Cambridgeshire County Council, Northamptonshire County Council and Milton Keynes Council) and subsidiary arrangements.
 - Any other joint arrangement.
22. This option could be complicated where an individual council creates an 'independence issue' with one specific bidder. 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.
23. There is a tension between obtaining economy of scale pricing from larger contracts under joint arrangements that also:
 - increase the risk of procurements being complicated by independence issues for individual councils, and,
 - may deter bids if providers evaluate the risk of preventing profitable consultancy work across a wide area.

Advantages

24. The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
25. There is greater opportunity for negotiating economies of scale by being able to offer a larger combined contract value to the firms.
26. The panel will be more independent of individual council partners.

Disadvantages

27. 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.
28. The appointment will need to manage any complications arising from independence issues or arrangements operating across several councils.

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

29. The Local Government Association (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 external audit firms nationally, maximising the opportunities for the most economic and efficient approach to procurement of external audit on behalf of the whole sector.
30. The LGA have already asked for indications from councils whether they would consider opting into such arrangements and the council was one of many local authorities who expressed an interest in this arrangement. Subsequently Public Sector Audit Appointments Ltd (PSAA) has now been specified as the sector-led appointing body under the Local Audit (Appointing Person) Regulations 2015.
31. LGA analysis indicates that using PSAA would be far cheaper for councils than every council procuring their external auditor separately. It would avoid the need for hundreds of separate procurement exercises and has the advantage for councils of saving the time and costs that would otherwise have been associated with establishing independent panels. Discussion between Norfolk chief finance officers has supported the use of PSAA as the recommended option going forwards in preference to a Norfolk wide panel.

Advantages

32. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities
33. By offering large contract values the external audit firms would be expected to offer better rates and lower fees than are likely to result from local negotiation
34. Any conflicts at individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.
35. The appointment process would 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.

Disadvantages

36. Individual elected members will have less opportunity for direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.
37. In order for the SLB to be viable and to be placed in the strongest possible negotiating position the SLB will need councils to confirm their intention to opt-in before final contract prices are known.

Additional considerations

38. There are no immediate risks needing action, however, early consideration by the council of its preferred approach will enable detailed planning to take place to achieve successful transition to the new arrangement in a timely and efficient manner.
39. The cost of establishing a local or joint auditor panel outlined in options 1 and 2 above would need to be estimated and included in the council's budget for 2016/17 and 2017/18. This would 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.
40. Opting-in to a national SLB provides opportunity to limit increases by entering in to a large scale collective procurement arrangement and would remove the costs of establishing an auditor panel.
41. 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.
42. 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.
43. 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.

Summary

44. The council has 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.
45. The LGA are working on developing a Sector Led Body. 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 responded positively when asked to consider whether it was interested in the option of opting in to a SLB. The response was made without obligation and does not form a binding commitment. A formal decision to opt-in will be required at a later stage.
46. The disadvantages of options (1) and (2) are considered sufficient to recommend option (3) to the council. Whilst a decision is not needed imminently the creation of a Norwich audit panel or the development of a joint audit panel with other councils would require the investment of officer time and costs.

- A local Audit Panel would require a minimum lead in period of 6-12 months to recruit additional independent members and undertake the necessary procurement exercise.
 - A Joint Audit Panel would require an additional 6 months to discuss and agree the terms of a joint panel. Thus work towards a joint panel would need to commence now.
47. Given all the issues set out in this report including the fact that any appointed auditor must comply with the national code as determined by NAO, Option (3) is recommended.
48. If Option (3) is agreed, a contingency plan will be developed to provide for the urgent delivery of an audit panel and procurement should the terms of a Sector Led Body solution not prove acceptable when final details are known.