

<b>Report To:</b>	<b>AUDIT PANEL</b>
<b>Date:</b>	1 November 2016
<b>Reporting Officer:</b>	Ian Duncan – Assistant Executive Director (Finance) Wendy Poole – Head of Risk Management and Audit Services
<b>Subject:</b>	<b>LOCAL AUDIT AND ACCOUNTABILITY ACT 2014 - CHANGES TO ARRANGEMENTS FOR APPOINTMENT OF EXTERNAL AUDITORS</b>
<b>Report Summary:</b>	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.
<b>Recommendations:</b>	<ol style="list-style-type: none"> <li>1. Members are requested to confirm the preferred option identified in Section 4.</li> <li>2. Members approve that the Council's Section 151 Officer can take the appropriate actions to progress a commissioning and procurement process, in proposals for the establishment of an Auditor Panel, in consultation with the other Greater Manchester Authorities and the Combined Authority.</li> </ol>
<b>Links to Community Strategy:</b>	The changes required by the Act will enable the Council to continue to be fully accountable to local people for its financial activities, as part of the Council's commitment to improvement, efficiency and good governance.
<b>Policy Implications:</b>	Changes to the terms of reference of the Audit Panel and the establishment of an Independent Auditor Panel will be required.
<b>Financial Implications:</b> <b>(Authorised by the Section 151 Officer)</b>	<p>Current external fees levels are likely to increase when the current contracts end in 2018.</p> <p>The cost of establishing a local or joint Auditor Panel outlined in options 1 and 2 below will need to be estimated and included in the Council's budget for 2017/18. This will 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.</p> <p>Opting-in to a national Sector Led Body 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.</p>
<b>Legal Implications:</b> <b>(Authorised by the Borough Solicitor)</b>	Section 7 of the Local Audit and Accountability Act 2014 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.

**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.

**Access to Information:**

The background papers can be obtained from the author of the report, Wendy Poole, Head of Risk Management and Audit Services by contacting:

 Telephone: 0161 342 3846

 e-mail: [wendy.poole@tameside.gov.uk](mailto:wendy.poole@tameside.gov.uk)

## 1. BACKGROUND TO THE ISSUE

- 1.1 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 October 2015, the Secretary of State Communities and Local Government 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.
- 1.2 The Council's current external auditor is Grant Thornton, this appointment having been made under at a contract let by the Audit Commission. Following closure of the Audit Commission the contract is currently managed by Public Sector Audit Appointments Limited, the transitional body set up by the Local Government Association with delegated authority from the Secretary of State Communities and Local Government. Over recent years we have benefited from reduction 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 current external audit fees are £172,500 per annum.
- 1.3 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.
- 1.4 The scope of the audit will still be specified nationally, the National Audit Office 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.

## 2. OPTIONS FOR LOCAL APPOINTMENT OF EXTERNAL AUDITORS

- 2.1 There are three broad options open to the Council under the Local Audit and Accountability Act 2014:
  - Option 1 - To make a stand-alone appointment**
- 2.2 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).
- 2.3 The Chartered Institute of Public Finance and Accountancy has recently published guidance for establishing an Auditor Panel and this is attached at **Appendix 1**.

***Advantages/Benefit***

- 2.4 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***

- 2.5 Recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract is estimated by the Local Government Association to cost in the order of £15,000 plus on going expenses and allowances.
- 2.6 The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
- 2.7 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**

- 2.8 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.
- 2.9 The Joint procurement exercise could involve the ten Greater Manchester Councils and the Greater Manchester Combined Authority.
- 2.10 At present, eight of the ten Greater Manchester Councils are audited by Grant Thornton and two are audited by KPMG. Given the level of collaboration, joint working and similar core functions across the bodies, there are likely to be benefits from including the ten districts and the combined authority in this procurement. In addition to this, an option could be extended to include health bodies at a later date, although it should be noted that they are currently working to a different timetable for appointments.

***Advantages/Benefits***

- 2.11 The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
- 2.12 There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms. It also enables the external auditor to obtain a fuller understanding of the audit requirements across the Greater Manchester level functions.

***Disadvantages/Risks***

- 2.13 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.
- 2.14 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**

2.15 In response to the consultation on the new arrangement the Local Government Association successfully lobbied for Councils to be able to 'opt-in' to a Sector Led Body appointed by the Secretary of State under the Act. A Sector Led Body 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***

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

2.17 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.

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

2.19 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. The Local Government Association are considering setting up such a body utilising the knowledge and experience acquired through the setting up of the transitional arrangements.

#### ***Disadvantages/Risks***

2.20 Individual elected members will have less opportunity for direct involvement in the appointment process other than through the Local Government Association and/or stakeholder representative groups.

2.21 In order for the Sector Led Body to be viable and to be placed in the strongest possible negotiating position the Sector Led Body will need Councils to indicate their intention to opt-in before final contract prices are known.

### **3. AUDITOR PANEL**

3.1 Unless opting into the Sector led body approach (Option 3), there will be a requirement to establish an independent Auditor Panel, either specifically for the Council or in collaboration with partners. The Auditor Panel role is different to that of the Audit Panel. Its functions are to advise the Council on:-

- selection and appointment of the auditor;
- resignation or proposals to remove the auditor;
- adoption of a policy on non-audit services;
- maintenance of independent relationship with the auditor; and
- any proposals to enter into limited liability agreements.

3.2 There is no specific reference in the Act of the Auditor Panel carrying out a contract oversight role but guidance from CIPFA does indicate this is a possible additional function that might be helpful.

3.3 It is anticipated that the Panel will benefit from support specifically from the Head of Paid Service, Treasurer/Section 151 Officer, Head of Internal Audit and Head of Procurement. It also acknowledged that there should be a relationship between the Auditor Panel and the Audit Panel, who will receive updates and assurances arising from the work of the external auditor; and are also well placed to comment on the quality and performance of services provided through the contract. The Act does allow for the Audit Panel to discharge the duties of the Auditor Panel but only if it meets the criteria set out below and that its role when acting as the Auditor Panel is clearly distinct from its role as the Audit Panel.

- 3.4 A key challenge for the Auditor Panel is to ensure appropriate appointments that meet the requirements of the Act. It is required that the Panel have at least three members but the majority, including the Chair, should be independent of the Council. It is permissible for Council elected members to be represented on the panel, but the majority of members and Chair are required to be independent. The definition of independence in the Act and supporting CIPFA guidance is explicit and allows little option other than through the advertisement and appointment of specific, external, independent members. Auditor Panel members will also be required to have the requisite skills and experience, which may not be readily identifiable or available given the specialist nature of the external audit contract and procurement processes.
- 3.5 If the Council progresses a single body appointment, it will be required to identify and appoint independent members for this process. The same principle will apply with a joint procurement but the collaborative option means that across the various Greater Manchester level authorities, only one group of independent members would be required and this increases the likelihood of successfully identifying suitably skilled and experienced independent persons to sit on the panel. These are required to be identified through advertisement arrangements and supported by clear panel member role descriptions. The Council and any joint procurement partners will be required to set levels of allowances and expenses.

#### **4. PREFERRED OPTION**

- 4.1 The ten Greater Manchester authorities and the Greater Manchester Combined Authority Treasurers are supportive of the proposal for a Greater Manchester level procurement.
- 4.2 This option allows for economies of scale, given the 2015/16 combined external audit and grant certification fees of these bodies was approximately £1.8m, whilst also enabling a single firm to be able to discharge external audit functions across Greater Manchester. This will allow the auditor to take a more strategic approach and should facilitate greater added value in supporting the audited bodies on complex accounting and audit matters.
- 4.3 A joint procurement is also likely to minimise the time and cost of separate procurements across Greater Manchester and will also aid the identification and appointment of an appropriate, effective Auditor Panel, which it is proposed comprises elected members representing the audited bodies as well as a majority of independent members and independent Chair secured following an open process of advertisement and recruitment.
- 4.4 No costing information is currently available.

#### **5. NEXT STEPS**

- 5.1 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.
- 5.2 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 and actions progressed the Audit Panel is asked to comment on the options and direct the Council's Section 151 to take forward a preferred option. This will then enable an action plan and detailed proposals to be developed in terms of the procurement approach; composition of the Auditor Panel; scope of audit work and services required; and engagement approach for working across Greater Manchester.

## **6. RECOMMENDATIONS**

- 6.1 Members are requested to confirm the preferred option identified in Section 4 of the report.
- 6.2 Members approve that the Council's Section 151 Officer can take the appropriate actions to progress a commissioning and procurement process, in proposals for the establishment of an Auditor Panel, in consultation with the other Greater Manchester Authorities and the Greater Manchester Combined Authority.