

From: John Simmonds, Cabinet Member for Finance & Procurement and Deputy Leader

To: County Council – 8<sup>th</sup> December 2016

Subject: Appointment of External Auditors for the 2018/19 accounts and beyond

Classification: Unrestricted

**Summary:** Following the abolition of the Audit Commission the Council will need to adopt a process for appointing an external auditor for the 2018/19 accounts and beyond. The Local Audit and Accountability Act 2014 (the Act) provides for 3 options for this appointment process and they are summarised below:

1. The Council establishes its own independent auditor panel.
2. The Council establishes a joint independent auditor panel with other Local Authorities.
3. The Council resolves to become an opted-in authority, allowing a sector led body or appointing person to appoint an external auditor on behalf of the Council and other opted-in authorities.

The Governance and Audit Committee has reviewed these options and has resolved to recommend to the Council that a sector wide procurement be pursued by an appointed sector led body. This body is Public Sector Audit Appointments Ltd (PSAA) operated by the Local Government Association (LGA).

The Act requires the decision to become an opted-in authority with a sector led body to be taken by the full Council.

**Recommendations:**

County Council is asked to:

- a) NOTE the changes in the external auditor appointment process following the Local Audit and Accountability Act 2014.
- b) NOTE the options available to the Council for the appointment of an external auditor for the 2018/19 accounts and beyond.
- c) RESOLVE that the Council opts-in to a sector led body (PSAA Ltd) to appoint external auditors for five financial years commencing 1<sup>st</sup> April 2018.

## **1. Background**

- The Local Audit and Accountability Act 2014 (the Act) brought the Audit Commission to a close, which was previously responsible for the appointment of external auditors for all local public bodies.
- Transitional arrangements introduced by the Act allowed auditors and Local Authorities to continue the contracts originally let by the Audit Commission, with external auditor appointments being made instead by Public Sector Audit Appointments Ltd (PSAA), an independent, not-for-profit company established by the Local Government Association (LGA).
- Transitional arrangements introduced by the Act will come to an end on 31st March 2018, and public bodies are required by legislation to have appointed new external auditors for the financial year beginning 1<sup>st</sup> April 2018 by the 31<sup>st</sup> December 2017.
- The Council's current external auditor is Grant Thornton, with audit fees of £155,925 per annum. There is a risk that fee levels could increase when the current contract ends in 2018.

## **2. Options for local appointment of external auditors**

- The Act set out the arrangements for the appointment of external auditors for the 2018/19 accounts and subsequent years, with the opportunity for authorities to make their own decisions about how and by whom their auditors are appointed.
- There are three broad options open to the Council under the Act and these are detailed below:

### **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, and 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.
- The principal benefits or advantages from such an approach are:
  - 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.

- The principal risks or disadvantages from such an approach are:
  - Recruiting to and maintaining the Auditor Panel, running the bidding exercise and negotiating the contract is likely to be resource intensive.
  - It is not evident whether there would be sufficient availability of suitable local independent members to form an effective independent Auditor Panel.
  - The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
  - While this option maximises local input, elected members or Council officers will not have a majority input in the appointment process.

### **Joint auditor panel appointment**

- The Act enables the Council to join with other authorities to establish a joint auditor panel, which will also need to consist of a majority of independent members (or wholly of independent members), and must be chaired by an independent member.
- The principal benefits or advantages from such an approach are:
  - Setting up a joint auditor panel will allow the Council to have local input to the appointment decision.
  - 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 external audit firms.
  - A larger procurement arrangement also reduces the risk of a lack of competition in the procurement process.
- The principal risks or disadvantages from such an approach are:
  - 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.
  - This option is dependent upon the co-operation and partnership of a number of local authorities, and there may not be an appetite from other local authorities in adopting this approach.

- While this option still allows for local input into the appointing decision, this local input will be completely independent of the Council and will be influenced by panel members from other authorities.

### **Opt-in to a sector led body**

- Regulations made under the Act allow authorities to 'opt in' for their auditor to be appointed by an 'appointing person', also known as a sector led body. A sector led body would have the ability to negotiate contracts with external audit firms nationally, maximising the opportunities for the most economic and efficient approach to procurement on behalf of the whole sector.
- Under the legislation this route can only be adopted if approved by the County Council.
- In July 2016 PSAA were specified by the Secretary of State as an appointing person under regulation 3 of the Local Audit (Appointing Person) Regulations 2015.
- As at July 2016, the LGA had received informal expressions of interest from over 200 authorities in favour of opting into a sector led body, which included all of the local authorities in Kent.
- The principal benefits or advantages from such an approach are:
  - The audit costs are likely to be lower than if the Council sought to appoint locally, as national large-scale contracts would benefit from economies of scale.
  - The overall procurement costs would be lower than individual or smaller scale procurement exercises.
  - The overhead costs for managing the contracts will be minimised through a smaller number of large contracts across the sector
  - The practical difficulties in establishing and maintaining an independent auditor panel or joint auditor panel with other local authorities would be by-passed.
  - PSAA will ensure the appointment of a suitably qualified and registered auditor and will monitor contract delivery and ensure compliance with contractual, audit quality and independence requirements.
- The principal risks or disadvantages from such an approach are:
  - Individual elected members would have less opportunity for direct involvement in the appointment process other than through the LGA and/or stakeholder representative groups.

- Final contract prices will be unknown at the point of the decision to become an opted-in authority with the PSAA.

### **3. Additional information**

- The scope of the external audit undertaken each year will still be specified nationally by the National Audit Office (NAO), which is responsible for writing the Code of Audit Practice which all local authority external audit firms must follow.
- Not all audit firms will be eligible to compete for the work. Only those that can demonstrate that they have the required skills and experience and be registered with a Registered Supervising Body approved by the Financial Reporting Council will be eligible for appointment. This means that procurement exercises undertaken from each of the aforementioned options would seek tenders from the same pool of firms, subject to the need to manage any local independence issues. The below firms are currently eligible for appointment:
  - BDO LLP
  - Deloitte LLP
  - Mazars LLP
  - Ernst & Young LLP
  - PricewaterhouseCoopers LLP
  - KPMG LLP
  - Grant Thornton UK LLP
  - Scott Moncrieff
  - Moore Stephens LLP
  - Cardens Accountants LLP

### **4. Governance and Audit Committee recommendation**

- On the 27th January 2016 and 21st July 2016 the Governance and Audit Committee reviewed the options available to the Council in appointing an external auditor for the 2018/19 accounts and beyond, and resolved to recommend to the Council that the preferred option of opting in to a sector led body be approved.

### **5. Next steps**

- PSAA has now formally invited the Council to opt in, and details relating to PSAA's invitation are provided in an Appendix to this Report (see Appendix 1).

- In summary the national opt-in scheme provides the following:
  - The appointment of a suitably qualified audit firm for each of the five financial years commencing 1 April 2018;
  - Appointing the same auditor to other opted in bodies that are involved in formal collaboration or joint working initiatives to the extent this is possible with other constraints;
  - Managing the procurement process to ensure both quality and price criteria are satisfied. PSAA will seek views from the sector to help inform its detailed procurement strategy;
  - Ensuring suitable independence of the auditors from the bodies they audit and managing any potential conflicts as they arise;
  - Minimising the scheme management costs and returning any surpluses to scheme members;
  - Consulting with authorities on auditor appointments, giving the Council/Authority the opportunity to influence which auditor is appointed;
  - Consulting with authorities on the scale of audit fees and ensuring these reflect scale, complexity and audit risk; and
  - Ongoing contract and performance management of the contracts once these have been let.
- Regulation 19 of the Local Audit (Appointing Person) Regulations 2015 requires that a decision to opt in must be made by a meeting of the Council. The Council then needs to formally respond to PSAA's invitation in the form specified by PSAA by the 9<sup>th</sup> March 2017.
- PSAA will commence the formal procurement process after this date. It expects to award contracts in summer 2017 and consult with authorities on the appointment of auditors so that it can make an appointment by the statutory deadline of December 2017.

## **6. Conclusion**

- There is a risk that current external fees levels could increase when the current contracts end in 2018.
- Opting-in to a national scheme provides maximum opportunity to ensure fees are as low as possible, whilst ensuring the quality of audit is maintained by entering in to a large scale collective procurement arrangement.
- If the national scheme is not used some additional resource may be needed to

establish an auditor panel and conduct a local procurement.

## 7. Recommendations

The County Council is asked to:

- a) NOTE the changes in the external auditor appointment process following the Local Audit and Accountability Act 2014.
- b) NOTE the options available to the Council for the appointment of an external auditor for the 2018/19 accounts and beyond.
- c) RESOLVE that the preferred external audit procurement route is via a sector led body (PSAA Ltd).

## 8. Appendices

Appendix 1 – Opt in invitation from PSAA Ltd

## 9. Background Documents

Local Audit and Accountability Act 2014

<http://www.legislation.gov.uk/ukpga/2014/2/contents/enacted>

Governance and Audit Committee meeting minutes – 21<sup>st</sup> July 2016

<https://democracy.kent.gov.uk/documents/g6091/Printed%20minutes%2021st-Jul-2016%2010.00%20Governance%20and%20Audit%20Committee.pdf?T=1>

Governance and Audit Committee meeting report pack – 21<sup>st</sup> July 2016 (pages 429-432)

<https://democracy.kent.gov.uk/documents/g6091/Public%20reports%20pack%2021st-Jul-2016%2010.00%20Governance%20and%20Audit%20Committee.pdf?T=10>

Governance and Audit Committee meeting minutes – 27<sup>th</sup> January 2016

<https://democracy.kent.gov.uk/documents/g6089/Public%20minutes%2027th-Jan-2016%2010.30%20Governance%20and%20Audit%20Committee.pdf?T=11>

Governance and Audit Committee meeting report pack – 27<sup>th</sup> January 2016 (pages 141-160)

<https://democracy.kent.gov.uk/documents/g5760/Public%20reports%20pack%2029th-Jan-2015%2010.30%20Governance%20and%20Audit%20Committee.pdf?T=10>

## 10. Contact details

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27 October 2016

**Email:** [appointingperson@psaa.co.uk](mailto:appointingperson@psaa.co.uk)

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Copied to: Andy Wood, Director of Finance, Kent County Council  
James Pigott, Head of Law, Kent County Council

Dear Mr Cockburn

### Invitation to opt into the national scheme for auditor appointments

As you know the external auditor for the audit of the accounts for 2018/19 has to be appointed before the end of 2017. That may seem a long way away, but as there is now a choice about how to make that appointment, a decision on your authority's approach will be needed soon.

We are pleased that the Secretary of State has expressed his confidence in us by giving us the role of appointing local auditors under a national scheme. This is one choice open to your authority. We issued a prospectus about the scheme in July 2016, available to download on the [appointing person](#) page of our website, with other information you may find helpful.

The timetable we have outlined for appointing auditors under the scheme means we now need to issue a formal invitation to opt into these arrangements. The covering email provides the formal invitation, along with a form of acceptance of our invitation for you to use if your authority decides to join the national scheme. We believe the case for doing so is compelling. To help with your decision we have prepared the additional information attached to this letter.

I need to highlight two things:

- we need to receive your formal acceptance of this invitation by 9 March 2017; and
- the relevant regulations require that, except for a body that is a corporation sole (a police and crime commissioner), the decision to accept the invitation and to opt in needs to be made by the members of the authority meeting as a whole. We appreciate this will need to be built into your decision making timetable.

If you have any other questions not covered by our information, do not hesitate to contact us by email at [appointingperson@psaa.co.uk](mailto:appointingperson@psaa.co.uk).

Yours sincerely



Jon Hayes, Chief Officer



## Appointing an external auditor

### Information on the national scheme

#### Public Sector Audit Appointments Limited (PSAA)

We are a not-for-profit company established by the Local Government Association (LGA). We administer the current audit contracts, let by the Audit Commission before it closed.

We have the support of the LGA, which has worked to secure the option for principal local government and police bodies to appoint auditors through a dedicated sector-led national procurement body. We have established an advisory panel, drawn from representative groups of local government and police bodies, to give access to your views on the design and operation of the scheme.

#### The national scheme for appointing local auditors

We have been specified by the Secretary of State for Communities and Local Government as the appointing person for principal local government bodies. This means that we will make auditor appointments to principal local government bodies that choose to opt into the national appointment arrangements we will operate for audits of the accounts from 2018/19. These arrangements are sometimes described as the 'sector-led body' option, and our thinking for this scheme was set out in a prospectus circulated to you in July. The prospectus is available on the [appointing person](#) page of our website.

We will appoint an auditor for all opted-in authorities for each of the five financial years beginning from 1 April 2018, unless the Secretary of State chooses to terminate our role as the appointing person beforehand. He or she may only do so after first consulting opted-in authorities and the LGA.

#### What the appointing person scheme will offer

We are committed to making sure the national scheme will be an excellent option for auditor appointments for you.

We intend to run the scheme in a way that will save time and resources for local government bodies. We think that a collective procurement, which we will carry out on behalf of all opted-in authorities, will enable us to secure the best prices, keeping the cost of audit as low as possible for the bodies that choose to opt in, without compromising on audit quality.

Our current role means we have a unique experience and understanding of auditor procurement and the local public audit market.

Using the scheme will avoid the need for you to:

- establish an audit panel with independent members;
- manage your own auditor procurement and cover its costs;
- monitor the independence of your appointed auditor for the duration of the appointment;
- deal with the replacement of any auditor if required; and
- manage the contract with your auditor.

Our scheme will endeavour to appoint the same auditors to other opted-in bodies that are involved in formal collaboration or joint working initiatives, if you consider that a common auditor will enhance efficiency and value for money.

We will also try to be flexible about changing your auditor during the five-year appointing period if there is good reason, for example where new joint working arrangements are put in place.

Securing a high level of acceptances to the opt-in invitation will provide the best opportunity for us to achieve the most competitive prices from audit firms. The LGA has previously sought expressions of interest in the appointing person arrangements, and received positive responses from over 270 relevant authorities. We ultimately hope to achieve participation from the vast majority of eligible authorities.

### **High quality audits**

The Local Audit and Accountability Act 2014 requires audit firms to be registered as local public auditors with one of the chartered accountancy institutes acting in the capacity of a Recognised Supervisory Body (RSB). The quality of registered firms' work will be subject to scrutiny by both the RSB and the Financial Reporting Council (FRC), under arrangements set out in the Act.

We will:

- only contract with audit firms that have a proven track record in undertaking public audit work;
- include obligations in relation to maintaining and continuously improving quality in our contract terms and in the quality criteria in our tender evaluation;
- ensure that firms maintain the appropriate registration and will liaise closely with RSBs and the FRC to ensure that any quality concerns are detected at an early stage; and
- take a close interest in your feedback and in the rigour and effectiveness of firms' own quality assurance arrangements.

We will also liaise with the National Audit Office to help ensure that guidance to auditors is updated as necessary.

### **Procurement strategy**

In developing our procurement strategy for the contracts with audit firms, we will have input from the advisory panel we have established. The panel will assist PSAA in developing arrangements for the national scheme, provide feedback to us on proposals as they develop, and help us maintain effective channels of communication. We think it is particularly important to understand your preferences and priorities, to ensure we develop a strategy that reflects your needs within the constraints set out in legislation and in professional requirements.

In order to secure the best prices we are minded to let audit contracts:

- for 5 years;
- in 2 large contract areas nationally, with 3 or 4 contract lots per area, depending on the number of bodies that opt in;
- to a number of firms in each contract area, in order to help us manage independence issues.

The value of each contract will depend on the prices bid, with the firms offering the best value being awarded larger amounts of work. By having contracts with a number of firms, we will be able to manage issues of independence and avoid dominance of the market by one or two firms. Limiting the national volume of work available to any one firm will encourage competition and ensure the plurality of provision.

## **Auditor appointments and independence**

Auditors must be independent of the bodies they audit, to enable them to carry out their work with objectivity and credibility, and in a way that commands public confidence.

We plan to take great care to ensure that every auditor appointment passes this test. We will also monitor significant proposals for auditors to carry out consultancy or other non-audit work, to protect the independence of auditor appointments.

We will consult you on the appointment of your auditor, most likely from September 2017. To make the most effective allocation of appointments, it will help us to know about:

- any potential constraints on the appointment of your auditor because of a lack of independence, for example as a result of consultancy work awarded to a particular firm;
- any joint working or collaboration arrangements that you think should influence the appointment; and
- other local factors you think are relevant to making the appointment.

We will ask you for this information after you have opted in.

Auditor appointments for the audit of the accounts of the 2018/19 financial year must be made by 31 December 2017.

## **Fee scales**

We will ensure that fee levels are carefully managed by securing competitive prices from firms and by minimising our own costs. Any surplus funds will be returned to scheme members under our articles of association and our memorandum of understanding with the Department for Communities and Local Government and the LGA.

Our costs for setting up and managing the scheme will need to be covered by audit fees. We expect our annual operating costs will be lower than our current costs because we expect to employ a smaller team to manage the scheme. We are intending to fund an element of the costs of establishing the scheme, including the costs of procuring audit contracts, from local government's share of our current deferred income. We think this is appropriate because the new scheme will be available to all relevant principal local government bodies.

PSAA will pool scheme costs and charge fees to audited bodies in accordance with a fair scale of fees, which has regard to size, complexity and audit risk, most likely as evidenced by audit fees for 2016/17. Pooling means that everyone in the scheme will benefit from the most competitive prices. Fees will reflect the number of scheme participants – the greater the level of participation, the better the value represented by our scale fees.

Scale fees will be determined by the prices achieved in the auditor procurement that PSAA will need to undertake during the early part of 2017. Contracts are likely to be awarded at the end of June 2017, and at this point the overall cost and therefore the level of fees required will be clear. We expect to consult on the proposed scale of fees in autumn 2017 and to publish the fees applicable for 2018/19 in March 2018.

## Opting in

The closing date for opting in is 9 March 2017. We have allowed more than the minimum eight week notice period required, because the formal approval process for most eligible bodies, except police and crime commissioners, is a decision made by the members of an authority meeting as a whole.

We will confirm receipt of all opt-in notices. A full list of authorities who opt in will be published on our website. Once we have received an opt-in notice, we will write to you to request information on any joint working arrangements relevant to your auditor appointment, and any potential independence matters that would prevent us appointing a particular firm.

If you decide not to accept the invitation to opt in by the closing date, you may subsequently make a request to opt in, but only after 1 April 2018. The earliest an auditor appointment can be made for authorities that opt in after the closing date is therefore for the audit of the accounts for 2019/20. We are required to consider such requests, and agree to them unless there are reasonable grounds for their refusal.

## Timetable

In summary, we expect the timetable for the new arrangements to be:

- Invitation to opt in issued 27 October 2016
- Closing Date for receipt of notices to opt in 9 March 2017
- Contract Notice Published 20 February 2017
- Award audit contracts By end of June 2017
- Consult and make auditor appointments By end of December 2017
- Consult and publish scales fees By end of March 2018

## Enquiries

We publish frequently asked questions on our [website](#). We are keen to receive feedback from local bodies on our plans. Please email your feedback or questions to: [appointingperson@psaa.co.uk](mailto:appointingperson@psaa.co.uk).

If you would like to discuss a particular issue with us, please send an email to the above address, and we will make arrangements either to telephone or meet you.