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**Subject:** **APPOINTMENT OF EXTERNAL AUDITORS AND AN AUDITOR PANEL – LOCAL AUDIT AND ACCOUNTABILITY ACT 2014**

**Meeting and Date:** **Governance Committee – 18 June 2015**

**Report of:** **David Randall, Director of Governance**

**Classification:** **Unrestricted**

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**Purpose of the report:** To advise members on the new arrangements for the appointment of External Auditors and the need for the creation of an Auditor Panel, which must have a majority of independent members.

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**Recommendation:**

1. That the Committee notes the issues arising for this Council from the provisions of the Local Audit and Accountability Act 2014.
2. That the Committee accepts that a joint arrangement for the formation of an auditor panel and for the subsequent procurement of external audit services as described in Option 1 is further pursued by this Council
3. That the Director of Finance, Housing and Community and the Director of Governance are authorised to pursue negotiations with Kent authorities and to report their findings to the next meeting of the Committee.

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## **1. Summary**

- 1.1 The Local Audit and Accountability Act 2014 received Royal Assent last year and has been brought into force on various dates since. It brings about changes to the external audit regime for local authorities. This paper sets out the issues arising for Members' consideration, in particular relating to the future appointment of External Auditors and the need to form an Auditor Panel.

## **2. Background**

### Local Audit and Accountability Act 2014

- 2.1 The Local Audit and Accountability Act 2014 abolishes the Audit Commission and (subject to transitional provisions) repeals the Audit Commission Act 1998. Its aim, as stated in DCLG guidance, is to give local bodies the freedom to appoint their own auditors from an open and competitive market and to manage their own audit arrangements, with appropriate safeguards to ensure independence.
- 2.2 The new local arrangements for the appointment of auditors are expected to start after the Commission's current contracts with audit suppliers end in 2016-17, although this could be later if the contracts are extended to 2019-20. At the moment we are awaiting confirmation that the extension will be granted. We therefore need to be prepared for a procurement process in late 2015 and early 2016.

2.3 This Council is a “relevant authority” within the scope of the Act, being listed in Schedule 2.

2.4 The key accounting and audit obligations will be to:

- Keep adequate accounting records and an annual statement of accounts for years ending 31 March; and
- Have accounts audited in accordance with the Act by a local auditor appointed under the Act.

#### Local Auditors

2.5 Part 3 of the Act (and Schedule 3) deal with the appointment of local auditors. The key points of interest are:

- Appointments may last for more than one year but a new appointment must be made at least once every five years – this does not prevent the re-appointment of an auditor. An authority may appoint two or more local auditors at once, either acting jointly or separately.
- The auditor(s) must be eligible (under Part 4 and Schedule 5 of the Act) and independent of the body being audited.
- Schedule 3 paragraph 1(3) provides that the auditor(s) must be appointed by the Council.
- Auditors must be appointed by the end of 31<sup>st</sup> December in the financial year before the financial year which will be covered by the accounts to be audited.
- Section 8 of the Act sets out the procedure for appointing auditors and imposes an obligation to consult and take into account the advice of the auditor panel on the selection and appointment of a local auditor. There is also a requirement to publicise the appointment.

#### Role of auditor panels

2.6 Section 9 of the Act requires the Council to have an auditor panel whose role is to advise the Authority on:

- The maintenance of an independent relationship with the appointed local auditor(s);
- The selection and appointment of a local auditor;
- Any proposal to enter into an agreement limiting the liability of its auditor(s), if the Council wanted to enter into such an agreement it would be a matter for the full Council.

2.7 The panel’s advice to the Authority must be published.

2.8 Schedule 4 makes more detailed provision about auditor panels. Paragraph 1 provides that the panel must be one of the following:

- An auditor panel specifically appointed as such by the Authority; or

- An auditor panel jointly appointed as such with one or more other authorities; or
- A committee (or sub-committee) of the Authority which meets the specified requirements for auditor panels (see below) and which has agreed to be the Authority's auditor panel. (For this Council, this would mean the Governance Committee. If this Council chose this approach, the constitution of the Governance Committee would need to change to an independent chairman and a majority of independent members.)

2.9 For this Council, the appointment of the auditor panel is a matter for the full Council.

#### Constitution of auditor panels

2.10 Paragraph 2 of Schedule 4 of the Act deals with the constitution of auditor panels. It has been amended by the Local Audit (Auditor Panel Independence) Regulations 2014 which inserted a revised definition of "independence".

2.11 An auditor panel must consist of a majority of (or wholly of) independent members, and must be chaired by an independent member.

2.12 The amendments to Paragraph 2 of Schedule 4 of the Act make specific provision relating to the Council. Paragraph 2 (6B) of Schedule 4 of the Act now provides that a member of its auditor panel cannot be "independent" as required if (s)he has been a:

- Member or officer of the Council within the previous five years; or
- Member or officer of another relevant authority, or an officer or employee of another entity, where the other relevant authority or entity is "connected with" the Council.

2.13 Other categories of person who are excluded from being independent members are those "connected with" current/prospective auditors; relatives or close friends of members/officers of relevant authorities and connected authorities and entities; and persons who have entered into contracts with the authority.

2.14 The definition of "connected entities" is set out at paragraph 8 of Schedule 4. It provides that an entity is connected with a relevant authority at any time if the Authority considers that, in accordance with proper practices in force at that time, the:

- Financial transactions, reserves, assets and liabilities of the entity are to be consolidated into the Authority's statement of accounts for the financial year in which that time falls;
- Authority's share of the entity's financial transactions, reserves, assets and liabilities is to be consolidated into the Authority's statement of accounts for that financial year; or
- Authority's share of the net assets or liabilities of the entity, and the profit or loss of the entity, are to be brought into the Authority's statement of accounts for that financial year.

#### Best value inspections

2.15 Schedule 10 of the Act deals with "best value inspections" and transfers the power (previously held by the Audit Commission) to order an inspection to the Secretary of

State for Communities and Local Government. In practice this is likely to mean that the auditors will no longer be required to give an opinion on the “best value” arrangements of a council, as they do annually at present.

- 2.16 It is not clear to what extent the Secretary of State is likely to order such inspections, or who would be asked to undertake them. However, it is reasonable to assume that they are likely to be the exception rather than the norm.

#### Abolition of the Audit Commission

- 2.17 As noted above, the Audit Commission ceased to function on 31 March 2015. The table below summarises the arrangements which will be in place from 1 April 2015 for Audit Commission functions.

<b>Audit Commission function</b>	<b>Destination</b>
Audit contracts	Transitional body (see below)
Certification work (Housing Benefit only)	Transitional body
VFM profiles tool	Transitional body
Code of Audit Practice and technical guidance	National Audit Office
VFM studies	National Audit Office
National Fraud Initiative	Cabinet Office
Counter-fraud	CIPFA
Corporate governance inspections	Secretary of State for Communities and Local Government

- 2.18 A transitional body has been established by the Local Government Association (LGA) as a private company. This company is called Public Sector Audit Appointments (PSAA). PSAA will operate between 2015 and 2017 (or to 2020 if any of the current contracts are extended by DCLG) and will:

- Appoint auditors from 1 April 2015;
- Set fees from 2016-17; and
- Monitor compliance and quality issues.

**Note:** Article 6(2) of the Local Audit and Accountability Act 2014 (Commencement No. 7, Transitional Provisions and Savings) Order 2015 allows during the transitional period that section 7 of the Audit Commission Act 1988 (which deals with the setting of fees) is kept ‘alive’ but the functions under it are delegated by the Minister to PSAA.

- 2.19 It is expected that local authorities will either join a collective procurement vehicle or establish their own auditor panels with a view to commencing procurement in late 2015 ready for appointment by December 2016 and operation from the 2017-18 financial year.

### 3. Options for Consideration

- 3.1 In line with the arrangements in place at other local authorities, the Council's current external audit contract (with Grant Thornton) runs to 2016-17 with the possibility of extension to 2019-20. However, it is appropriate that this Council begins to address the issues arising from the new external audit regime. The specific issues for consideration are the structure and appointment of the Auditor Panel and the procurement of the service:
- 3.2 Option 1. The Council could seek to form a joint auditor panel and a joint procurement arrangement with neighbouring authorities (this could be with East Kent Authorities or could be wider to cover the whole of Kent) so that there is a single auditor panel and single external audit contract for the entire area (however defined). This would aim to take advantage of better purchasing power and provide a more attractive offer for the external auditor bidders. This is particularly important as local authority audit is a specialised activity. The market for this service may develop, but we should not assume it will, and at present, only the larger accounting firms have the experience and specialist staff to undertake the work. These firms would be unlikely to seek work for one or two isolated districts, and then procurement could be problematic. In contrast a contract for Kent or the south east (as at present) would be more attractive and would potentially maintain economies of scale.
- 3.3 At the present time, our external auditors, Grant Thornton provide the service across all of Kent. There may be some additional bureaucracy associated with creation and management of a joint auditor panel, although it would avoid the need for each body to source its own independent members. In reality the panel is unlikely to meet very often and the governance arrangements once established should be relatively easy to manage. This approach would require delegations from (or feasibly to) this Council from other Councils to form a lead authority for the appointment of the panel and for future governance and procurement purposes. There would also need to be joint arrangements in place to introduce and manage an allowance scheme for the panel.
- 3.4 Option 2. Alternatively, the Council could form its own auditor panel and undertake its own procurement arrangements. This approach if replicated elsewhere, could lead to the panels in each authority in Kent, with associated administration and governance to create and maintain each panel. Procurement would then be undertaken for this Council, the small size of the audit contract may not be attractive to the bidders, who in reality are likely to be from the bigger accounting firms. This approach raises the question as to whether there is an available and willing source of independent members across Kent to appoint to numerous auditor panels, recognising that there will need to be a majority of independent members, including the chair on the panel and the panel will have limited responsibilities and in reality will meet infrequently, and will be dealing with an area that is to some degree specific to local authorities. If the Council was to choose this approach, it is suggested that the auditor panel should be formed of three independent members and two district councillors. Three or more district councillors would mean that the panel would be treated as a committee of the Council and impact on the political balance rules. It is also suggested that the auditor panel doesn't become a committee or sub-committee of the Council (i.e. becoming the Governance Committee).
- 3.5 Option 3. The Council could have a hybrid of options 1 and 2. It could form its own auditor panel, but seek to procure jointly with neighbours, either within East Kent or with the wider Kent authorities. This would allow the Council's own auditor panel to advise this Council, whilst benefiting from joint procurement as described above. This raises the same question of available and willing independent members as described

above. It also raises the issue of the composition of the panel, it would again be suggested that a 3:2 split is the most suitable arrangement.

#### **4. Preferred Option**

- 4.1 On balance, it would seem sensible to pursue Option 1, initially with our East Kent neighbours. DDC officers have started very early dialogue, but have received no feedback at the time of preparing this report. However, with Member direction and support this can be taken further.
- 4.2 Whichever option is approved, the full Council will initially need to delegate the interview process to either a committee of Council or a specially formed sub-committee or to officers of the Council or to another Council (if a joint approach is approved). Ultimately Council will be required to approve the auditor panel appointments.

#### **5. Resource Implications**

- 5.1 There will be officer time required to introduce these arrangements. There will be costs associated with advertising and then interviewing for the independent members. Subsequently there will be the cost of an allowance scheme.

#### **6. Corporate Implications**

- 6.1 Comment from the Section 151 Officer: The Director of Finance, Housing and Community has been consulted in the preparation of this report and has no further comments to make (MD).
- 6.2 Comment from the Solicitor to the Council: The Solicitor to the Council has been consulted in the preparation of this report and has no further comments to make.
- 6.3 Comment from the Equalities Officer: This report does not specifically highlight any equalities implications however, in discharging their responsibilities members are required to comply with the public sector equality duty as set out in section 149 of the Equality Act 2010 <http://www.legislation.gov.uk/ukpga/2010/15>
- 6.4 Other Officers (as appropriate):

#### **7. Appendices**

None

#### **8. Background Papers**

Local Audit and Accountability Act 2014

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