

<b>Subject:</b>	<b>APPOINTMENT OF EXTERNAL AUDITORS – LOCAL AUDIT AND ACCOUNTABILITY ACT 2014 AND THE LOCAL AUDIT (APPOINTING PERSON) REGULATIONS 2015</b>
<b>Meeting and Date:</b>	<b>Governance Committee – 3 December 2015</b> <b>Council – At the Appropriate Time</b>
<b>Report of:</b>	<b>David Randall, Director of Governance</b>
<b>Classification:</b>	<b>Unrestricted</b>
<b>Purpose of the report:</b>	Following an initial report to the committee on 18 June 2015, this report provides further additional information and updates members on the routes available for the future appointment of External Auditors, including the option of becoming an opted in authority for a sector lead appointment or the options of creating our own or a joint Auditor Panel to secure the appointment..
<b>Recommendation:</b>	<ol style="list-style-type: none"> <li>1. That the Committee notes the issues arising for this Council from the provisions of the Local Audit and Accountability Act 2014 and The Local Audit (Appointing Person) Regulations 2015.</li> <li>2. That the Committee agrees that this Council seeks to opt in to the sector lead procurement of the external audit service as outlined in option 1 of this report.</li> <li>3. That the Council be recommended to accept an invitation to become an opted in authority for the purpose of appointing a local auditor to audit the accounts of this Council at the appropriate time.</li> </ol>

## 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. The original paper of 18<sup>th</sup> June 2015 set 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.
- 1.2 Since preparing the original report and following discussions with the other Kent Authorities, it has become apparent that there was additional legislation that I missed and wasn't included in the original report. This is included in The Local Audit (Appointing Person) Regulations 2015, not as part of the Accounts and Audit Regulations. This provides an additional option, in that a sector lead appointing person makes the appointment of the auditor, avoiding the need for an Auditor Panel.
- 1.3 This report updates the original report of 18<sup>th</sup> June 2015 to reflect the additional legislation and the discussions that have taken place with the other Kent authorities and offers an alternative recommended way forward.

## 2. Background

- 2.1 There are two significant pieces of legislation that are relevant to the future appointment of auditors:

Local Audit and Accountability Act 2014

- 2.2 The Local Audit and Accountability Act 2014 abolished 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.
- 2.3 The new local arrangements for the appointment of auditors were originally expected to start after the Commission's current contracts with audit suppliers ended in 2016-17. However, our current external auditors, Grant Thornton believe that the Secretary of State has extended their audit contract by 1 year to include the 2017-18 year. Therefore, it is likely that arrangements for new auditors to audit the 2018/19 accounts will need to be finalised by 31<sup>st</sup> December 2017, so that the new auditors are in place by 1<sup>st</sup> April 2018. This allows the Council more time to finalise its arrangements than we originally envisaged. However, this could mean that we have a period with two different external auditors, as Grant Thornton will be auditing the 2017/18 accounts up to around October 2018, whilst a potentially different auditor will be in place from April 2018 preparing to audit the 2018/19 accounts.
- 2.4 This Council is a "relevant authority" within the scope of the Act, being listed in Schedule 2.
- 2.5 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

- 2.6 Part 3 of the Act (and Schedule 3) deal with the appointment of local auditors (unless appointed under the Local Audit (Appointing Persons) Regulations 2015 (see paragraph 2.16 et seq.). 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(1) provides that the auditor(s) must be appointed by the Council (rather than by the executive).
  - 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 if appointed by the Council 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

- 2.7 If the appointment is not to be made by the Appointed Person, Section 9 of the Local Audit and Accountability Act 2014 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.
- 2.8 The panel's advice to the Authority must be published.
- 2.9 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.)
- 2.10 For this Council, the appointment of the auditor panel would be a matter for the full Council.
- 2.11 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".
- 2.12 An auditor panel must consist of a majority of (or wholly of) independent members, and must be chaired by an independent member.
- 2.13 The amendments to Paragraph 2 of Schedule 4 of the Act make specific provision relating to the Council. Paragraph 2 (2) 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.

- 2.14 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.
- 2.15 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.

#### Local Audit (Appointing Person) Regulations 2015

- 2.16 A separate set of regulations from the Local Audit and Accountability Act and the Accounts and Audit Regulations, The Local Audit (Appointing Person) Regulations 2015 were laid before Parliament in February 2015. The new regulations allow local government to establish collective procurement arrangements.
- 2.17 A framework is set out in regulations to allow authorities to opt into collective procurement arrangements established by the local government sector. The regulations set out the process for the Government to approve an organisation to act as a sector-led body. The Secretary of State has designated Public Sector Auditor Appointments Ltd, a sector-led body recommended by the local government sector as an appointing person and given them the necessary powers and duties to act as a collective procurement body. (see paragraph 2.24)
- 2.18 The regulations set out the process by which authorities can choose to participate in the sector-led arrangements. Essentially, the appointed person must invite authorities to become opted in authorities. The authorities to whom the invitation is issued must then individually decide whether to accept the invitation. The decision to accept the invitation may only be accepted by the full council. If an authority accepts then, the appointment of the auditor is made by the appointing person. The regulations also set out the powers and functions of the appointing person which include, for example, a power to levy fees on opted-in authorities and a corresponding duty on the body to consult before setting those fees.
- 2.19 These regulations modify parts of the Local Audit and Accountability Act 2014, as they apply to authorities that have opted in to the collective procurement arrangements. This includes the provision that Authorities that opt in and do not make their own appointment will not need to establish an independent auditor panel.
- 2.20 The regulations still requires the Appointing Person to make a new appointment at least every five years. In the vast majority of cases, that will require the Council to go through a full EU-compliant appointment process, taking advice from their

independent auditor panel. That will ensure that authorities regularly review the quality of the audit service and that auditors are appointed through a fair and compliant process. If the incumbent firm is found to be the best candidate through such an open and competitive process, we do not think it right that Government should prevent its reappointment.

- 2.21 In addition, the Financial Reporting Council's ethical standards already require that key audit staff, such as the lead partner are rotated on a regular basis. The Government believe that, along with the other provisions about auditor appointment and removal, the requirements for a new appointment every five years and for the rotation of key audit staff provide sufficient safeguards to ensure the independence of the auditor."

#### Best value inspections

- 2.22 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.
- 2.23 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

- 2.24 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

- 2.25 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:

- During the transition, appoint auditors from 1 April 2015;
- Set fees from 2016-17; and
- Monitor compliance and quality issues.

- 2.26 As the “Appointing Person” Public Sector Audit Appointments will make the auditor appointment for those Councils that become an opted in authority from the end of the transitional period.

**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

- 2.27 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, but we believe this has been extended to 2017-18, with the possibility of a further extension to 2019-20. However, it is appropriate that this Council addresses the issues arising from the new external audit regime. The specific issues for consideration are whether the Council wishes to opt in to the sector lead appointment of our external auditor, or if not the structure and appointment of the Auditor Panel and the procurement route for the service:

- 3.2 Option 1. The Council could seek to opt in to the sector lead procurement of the external audit service. The Local Audit (Appointing Person) Regulations 2015 Part 2, paragraph 3 enables the Secretary of State to specify an Appointing Person to appoint a local auditor to audit the accounts of an opted in authority. Using Public Sector Audit Appointments as the Appointing Person is attractive as it removes a great deal of administration and arrangements that will need to be put in place and improves the effectiveness of procuring in what is a specialised activity area. The market for this service is very limited and at present, only the larger accounting firms have the experience and specialist staff to undertake the work. These firms would be much more likely to bid for work through a bigger procurement exercise rather than seek work from one or two isolated districts or even an area as large as Kent. In contrast a contract for the south east (as at present) would be more attractive and would potentially attract the right players and maintain economies of scale.

- 3.3 If the Council chooses not to join the sector lead route, there are three alternatives:

- 3.4 Option 2. 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.

- 3.5 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.
- 3.6 Option 3. 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).
- 3.7 Option 4. 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. All participating Councils in this arrangement would have to pass the same resolution, not insurmountable, but with some difficulties. 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 It would seem sensible to pursue Option 1. This offers the potential for economies of scale and importantly a high probability of securing auditors with the necessary experience to effectively audit this local authority. If the Council approves this option, during the compulsory appointing period, which is not yet specified, the Council will need to give notice to the Appointing Person of our decision to become an opted authority.

- 4.2 Options 2 to 4 would require the full Council to initially 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 was approved). Ultimately Council would be required to approve the auditor panel appointments.

5. **Resource Implications**

- 5.1 Option 1 will incur minimum costs for the Council. Options 2 to 4 will require officer time 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.
- 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>

7. **Appendices**

None

8. **Background Papers**

Local Audit and Accountability Act 2014

The Local Audit (Appointing Person) Regulations 2015

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