

Audit Committee

Item No 14

Report title:	Local Audit and Accountability Act 2014 – External Auditor Appointments Implementation
Date of meeting:	22 September 2016
Responsible Chief Officer:	Executive Director of Finance
<p>Strategic impact</p> <p>There is a statutory requirement for the Council's Statement of Accounts to be independently audited. The Local Audit and Accountability Act 2014 (the Act) brings changes to the appointment process for external auditors, referred to in the Act as a 'Local Auditor'.</p> <p>The contract for the present external auditors, Ernst & Young, is due to expire 31 March 2018. The Council must, by 31 December 2017, have 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.</p> <p>The Act and the regulations provide options for how an external auditor is procured, some of which would need significant preparation and changes to the Council's Constitution. The Committee, as those charged with governance, are asked to agree the preferred option on economic and efficiency criterion.</p>	

Executive summary

The last Government introduced legislation, the Local Audit and Accountability Act 2014, to abolish the Audit Commission. The Commission was subsequently wound up by 31 March 2015, so no longer appoints our External Auditors (2.1). Temporary arrangements were put in place by the Government to maintain existing contracts (explained at 2.2) and the legislation sets out the arrangements for how External Auditors would be appointed going forward.

The Council has four options to procure its External Audit service for the audit of financial statements for 2018/19 onwards (2.4). Prior to 31 December 2017, it should either:

- Direct the Executive Director of Finance to contract with a 'specified person' (in this case Public Sector Audit Appointments Ltd (PSAA)) as allowed under Part 3 Section 17 of the Act (explained at 2.4.1) **the preferred option**; or
- Set up an Auditor Panel (explained at 2.4.2) by:
 - Recommending to Policy and Resources Committee to request the Constitutional Advisory Group to amend the Constitution to establish an

Auditor Panel in compliance with Section 9 and Schedule 4 (part 1.(1) a) of the 2014 Act and relevant regulations

- have appointed a suitable panel; and
- undertaken or participated in, a procurement exercise to appoint a local auditor, to be in place by 1 April 2018
- Set up an Auditor Panel (as above) with the intention to host a partnership, with other local authorities, as allowed for, per Schedule 4 part (1. (1) b) of the Act 2014 and relevant regulations (explained at part 2.5); or
- Join an appropriate Auditor Panel, in partnership, as allowed for, per Schedule 4 part (1. (1) b) of the Act 2014 and relevant regulations (explained at part 2.5);

The wider context of External Audit provision for Council owned entities is set out in this report for reference (explained at part 2.17).

The Audit Committee, as those charged with governance, is recommended to:

Consider:

- **The requirements and timescales set out in the Act (explained at 2.3 and 2.4)**
- **The advantages and disadvantages of the available options for procuring an External Auditor (Local Auditor) as required by the Act (explained in Appendix B); and**

Agree:

- **To commend to Full Council to direct the Executive Director of Finance to formally 'opt in' with the Government's designated appointing person (in this case PSAA), as allowed under Section 17 of the Act, as the preferred option offering the greatest potential economic and efficiency savings.**

1. Proposal (or options)

1.1 The options are set out in the Executive Summary above

1.2 In producing this paper, Democratic Services have been consulted.

2. Evidence

- 2.1 Our existing external auditor was appointed by the Audit Commission. EY were appointed 1 September 2012 for the 2012/13 audit with the closure of the Audit Commission's District Audit Service and the letting of those contracts to commercial suppliers. The last Government asked the Commission to set fees for 2015-16.
- 2.2 The present management of the External Auditors is the responsibility of Public Sector Audit Appointments Ltd (PSAA). This company will operate between 2015 and 2018. PSAA have published a [prospectus and frequently asked questions](#) (please click underlined text to link to the web page). Currently PSAA:
- Set scale fees for our audits from 2016-17 and for approving fee variations from 1 April 2015
 - Monitor contract compliance and the quality of auditor' work
 - Publish reports on the quality of audit work and on compliance with key indicators
 - Maintain and make public the VFM Profile tools
- 2.3 The Government allowed that the existing External Audit contracts, including Norfolk County Council's, could be extended to 2020, however it was later announced that contracts would be extended to 31 March 2018. Therefore, at present the current external auditor's contract expires at the end of the 2017/18 financial year.
- 2.4 The Local Audit and Accountability Act 2014 (The Act) states that:
- 2.4.1 The Secretary of State can appoint an 'Appointing Person', who will have the ability to appoint an external auditor to a relevant authority, at Part 3 Section 17 of the Act 2014. The Government announced in July 2016 that PSAA has been specified by the Government to become the body which is authorised to make future audit appointments on behalf of principal local authorities. PSAA were the sector led body for the appointment of auditors. The first appointments made under these arrangements will commence in relation to the financial year 2018-19. The Council can therefore opt in to this arrangement, rather than undergo a procurement exercise itself. PSAA state that approaching 270 councils and other local bodies have already expressed an interest in joining the national scheme which they are now developing. The Audit Committee considered a [presentation about Local Audit Procurement \(the Appointing Person\)](#) (see Minutes Appendix A) by a Local Government Association representative at its June 2016 meeting. This preferred option would offer the maximum economies of scale, potentially giving significant economic and efficiency savings for the Council

- 2.4.2 Should the Council not wish to opt in to use PSAA to secure a Local Auditor, Part 3 s8(1) and Schedule 4 of the Act outline the procedure for appointing an external auditor, which the Council must follow, that the Council "...must consult and take into account the advice of its auditor panel on the selection and appointment of a local auditor". CIPFA have published a Guide to Auditor Panels which has been circulated earlier to members of this Committee. Key points to note are that:
- The requirement to have an Audit Panel is new and will require the Council to amend its Constitution to allow for the creation of such an Audit Panel. Changes to the Constitution are enabled through a recommendation to the Policy and Resources Committee on to the Constitutional Working Group which makes recommendations to full Council
 - Such an 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.
- 2.4.3 A new Local Auditor contract, must be in place by 1 April 2018. In accordance with Part 3 s7(1) of the Act, the appointment must be finalised by 31 December 2017. The appointment can be for between one and five years, unless the Secretary of State directs otherwise, and the auditor must be eligible for appointment and must not be prohibited from doing so by law.
- 2.5 An Audit Panel established under the Act must either be appointed by the Council or by the Council and one or more other relevant authorities, as per Schedule 4 (part 1 (1) b). The Council can use another Authority's Panel. The Council could therefore either choose to host or join an appropriate partner or group of partners who shared a desire to work together to operate a 'shared Auditor Panel'. Such a shared panel may secure some economies of scale and administration for the participants.
- 2.6 Exploratory discussions with local Finance Leads have established a preference for the PSAA route. The Council has not been approached regarding developing any partnership Audit Panel and no preparation has been made to lead/host such a panel to date, therefore this is not a preferred option.
- 2.7 The NAO have published [a leaflet](#) explaining their role in relation to Local Auditors which sets out about maintaining standards, in particular their Code of Audit Practice for Local Auditor's work.
- 2.8 The implementation options including the, who, what, why and when action needs to happen are set out in **Appendix A**.

PSAA (the preferred option)

- 2.9 A collective approach would offer the best economies of scale, competitive fees and be the most efficient to set up and maintain. The PSAA have published a prospectus (see 2.2.) which sets out their plans to develop the service. To implement the PSAA option the Committee, as those charged with governance on behalf of the Council, would need to commend the Full Council to direct the Executive Director of Finance to formally 'opt in' to a contract with PSAA.

PSAA would then:

- request details from the Council to assist them with securing audit contractors
- procure the audit providers on a framework
- publish a scale of fees
- consult on the appointment of the Council's local auditor
- make the appointment
- manage this appointment
- charge a scale fee and administration fee

Audit Panel

- 2.10 Establishing an Audit Panel would not offer economies of scale, so fee rates could be higher. Establishing and maintaining an Audit Panel would incur set up and ongoing costs, including additional democratic support and allowances. To implement the Audit Panel option the Committee, as those charged with governance on behalf of the Council, would need to direct the Executive Director of Finance to formally request the Policy and Resources Committee to request the Constitutional Advisory Group to implement an auditor panel in order to comply with Schedule 4 of the Act. This would include consideration of the options for creating Auditor panels and the issues surrounding the constitution of those panels, described below in summary:

- The Auditor Panel could be appointed by the County Council, using one of the following options:
 - A panel appointed as an auditor panel by the County Council, or
 - A panel appointed as an auditor panel by the County Council and one or more other relevant authorities (See below) , or
 - An auditor panel appointed by a relevant authority other than the County Council, or
 - A committee or sub-committee of the County Council.

NB:- CIPFA (Chartered Institute of Public Finance and Accountancy) has issued guidance on auditor panels, including an analysis of the possible advantages and disadvantages of these options.

- Whichever audit panel option is selected, the Audit Panel must:

- Consist of a majority of independent members, or wholly of independent members, and
 - Be chaired by an independent member.
- A member of the auditor panel is “independent” if the panel member:
 - Has not been a member or officer of the Council within the past 5 years, and
 - Has not been an officer or employee of an entity connected with the Council within the past 5 years, and
 - Is not a relative or close friend of a member or officer of the Council, or an officer or employee of an entity connected with the Council.
- 2.11 The Council’s existing Audit Committee has no independent members and therefore in accordance with schedule 4 of the Act, cannot presently act in the capacity of an auditor panel. However, the Audit Committee may wish to consider what role is appropriate for them in relation to the governance of:
- The external audit procurement process, and
 - The subsequent management / oversight of the external audit contract.

Hosting/Joining a partnership Audit Panel

- 2.12 The Council has not been approached regarding developing any partnership Audit Panel and no preparation has been made to lead/host such a panel to date, therefore this is not a preferred option. The benefits and dis-benefits of this option are described in **Appendix B**.

Other Considerations

- 2.13 The Council’s External Auditor will need to work with the chosen external auditors for the Council’s wholly owned entities that are part of the Council’s Consolidated Accounts. Consideration should be given to the audit appointments across the group (e.g. interactions with the Norse Group and Independence Matters Ltd).

3. Financial Implications

- 3.1 The specific costs of potential options are not available from PSAA and have not been quantified at this stage but will be considered in the 2017-18 budget

setting process. For indicative purposes the current fee level for the Audit of the Council's Statement of Accounts is £117,045.

- 3.2 If the PSAA option were to be agreed then a scale fee and management fee would be charged. It is not anticipated that any management fee will exceed the potential reductions in audit fees from providers due to the economies of scale.
- 3.3 If the Audit Panel option were agreed the Council must provide for reasonable expenses and allowances incurred by the panel in exercise of their duties. This may be shared if a partnership panel were established.

4. Issues, risks and innovation

- 4.1 There are legal implications for failure to appoint a local auditor in compliance with the Local Audit and Accountability Act 2014; most notably that the Secretary of State would need to be informed and who could then direct an appointment.
- 4.2 There are no implications with respect to:
- Other resource implications (staff, property)
 - Risks
 - Equality
 - Human rights implications
 - Environmental implications
 - Health and safety issues

5. Background

- 5.1 The Committee received a [presentation](#) (please click on the underlined text to link to the minutes) from an LGA representative at its meeting in June 2016 reproduced at Appendix A of those minutes.

6. Officer Contact

If you have any questions about matters contained in this paper please get in touch with:

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Implementation Options

Appendix A

Over the next 12 months to comply with the act the County Council must implement one of the following two options:

What needs to be done:	Why it needs to be done:	How does it need to be done:	When does it need to be done:	Who needs to lead on this:
If PSAA (the preferred) option: The Full Council to direct the Executive Director of Finance to formally 'opt in' to the PSAA service.	In order to fulfil Part 3 Section 17 of the Act.	Resolution of the September 2016 Audit Committee	Resolution of the September 2016 Audit Committee	Executive Director of Finance
If Audit Panel Option: Amendment to the Council's constitution to allow for the creation of an auditor panel	In order to fulfil the requirements of Part 3 s8(1) of the Local Audit and Accountability Act 2014	Audit Committee Chair to make request to P&R Chair to initiate.	Constitution to be amended by 30 December 2016	Head of Democratic Services (Chris Walton)
Undertake a recruitment process to appoint individuals to the auditor panel, this may also include giving the panel members the necessary training to fulfil their role.		Audit Committee Chair to request Democratic Services to undertake a recruitment exercise to produce a shortlist of appropriate candidates. (To be decided, the role the Audit Committee will have	Audit Panel to be in place by 30 June 2017	Recruitment & Appointment: Audit Committee / Head of Democratic Services Training: Norfolk Audit Services

Implementation Options

Appendix A

What needs to be done:	Why it needs to be done:	How does it need to be done:	When does it need to be done:	Who needs to lead on this:
		with regards to the interview and appointment of the participants of the Independent Auditor Panel)		
Decide upon appropriate procurement option; carry out, or be a party to, a procurement exercise for an external auditor	In order to fulfil the requirements of Part 3 s7(1) of the Local Audit and Accountability Act 2014	Advice to be sought from Head of Procurement on the proposed specific procurement route to take, timescales, specification, etc.	To be <u>completed</u> by 31 October 2017	Executive Director of Finance (Simon George) and Head of Procurement (Alan Collier)
Council Receive advice / a recommendation back from the audit panel on the preferred external audit provider	To comply with Part 3 s8(1) of the Local Audit and Accountability Act 2014	The Independent Auditor Panel to consider the results of the procurement exercise and make a recommendation to the full Council.	To have a preferred provider by 30 November 2017	Independent Audit Panel
Appoint an external audit provider	To comply with Part 3 s7(1) of the Local Audit and Accountability Act 2014		To have appointed an external audit provider by 31 December 2017	Full Council
Publicise the appointment, including the advice from the audit panel	To comply with Part 3 s8(2) of the Local Audit and Accountability Act 2014		Within 28 days of the appointment of the external auditor.	Head of Democratic Services

Advantages and Disadvantages Analysis:

Option	Possible Advantage	Possible Disadvantage
Opt in to PSAA (preferred option)	<ul style="list-style-type: none"> • Maximum economies of scale for economic and efficiency benefits • Minimum administration • Scale of Fees approach • High standards of quality and maximum leverage on providers in case of disputes 	<ul style="list-style-type: none"> • Limited choice of external audit provider • Management fee will be levied by PSAA
Set up own separate and individual Audit Panel to oversee separate and individual procurement ¹	<ul style="list-style-type: none"> • Full ownership of the process. • Fully bespoke contract with the auditor. • Tendering process more based on local circumstances (within EU procurement rules). 	<ul style="list-style-type: none"> • May experience difficulties in appointing majority independent panel members and independent panel chair as per the regulations. • Will need to ensure that panel members are suitably qualified to understand and participate in the panel's functions. • Will have to cover panel's expenses completely. • May not be able to procure at a lower cost, for example, depending on authority location, where there will be a risk of limited provider choice and a single authority contract may be less attractive to some providers. • Will not achieve economies of scale.
Set up a panel jointly with another authority / authorities as part of a procurement exercise for joint contract covering more than one authority or multiple separate contracts ¹ .	<ul style="list-style-type: none"> • Less administration than a sole auditor panel. • Will be able to share the administration expenses. • May be easier to attract suitable panel members. <p>If procuring a joint audit contract:</p> <ul style="list-style-type: none"> • May still be relatively locally tailored process. • May be able to achieve some economies of scale. <p>If procuring separate audit contracts:</p>	<p>If procuring a joint audit contract:</p> <ul style="list-style-type: none"> • May need to compromise on the arrangements or auditor contract. • May not end up with first choice of auditor, compared to an individual auditor panel. If a large group of authorities work together and decide to appoint one joint audit contract across all authorities, a joint panel may be more likely to

Option	Possible Advantage	Possible Disadvantage
	<ul style="list-style-type: none"> An opportunity for fully bespoke contracts with the auditor if the group of authorities can agree. 	<p>advise appointment of an audit it considers suitable for all authorities taken together.</p> <ul style="list-style-type: none"> Need to agree appointment of members across multiple authorities and set up an appropriate joint decision-making process Limited economies of scale
Use existing committee or sub-committee ¹	<ul style="list-style-type: none"> Existing administrative structure in place. Existing (sub) committee should already have a better basic understanding of the authority's objectives and requirements. 	<ul style="list-style-type: none"> Need to appoint a new (sub) committee member/s and Chairman to comply with independence regulations.
Use another authority's panel ¹	<ul style="list-style-type: none"> Will not have to set up an auditor panel. Arguably most independent option for the authority using the host authority's panel. 	<ul style="list-style-type: none"> The panel may not understand the specific needs of the authority. May need to enter into a formal arrangement with the other authority. May be difficult to find an authority willing to enter into such an arrangement. May be more difficult to ensure adequate liaison with authority's own audit committee.

¹Source: CIPFA Guide to Auditor Panels December 2015