

**BIRMINGHAM CITY COUNCIL**

**PUBLIC REPORT**

**Report to: AUDIT COMMITTEE**

**Report of: Strategic Director of Finance & Legal**

**Date of Meeting: 26 July 2016**

**Subject: CHANGES TO ARRANGEMENTS FOR APPOINTMENT OF EXTERNAL AUDITORS**

**Wards Affected: All**

**1. Purpose of Report**

1.1. 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.

1.2. The Council will need to consider the options available (detailed in appendix 1) and put in place new arrangements in time to make a first appointment by 31 December 2017.

**2. Recommendation**

2.1. To support the Local Government Association (LGA) in setting up a national Sector Led Body by indicating an intention to “opt-in”

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### 3. Compliance Issues

3.1 Are Decisions consistent with relevant Council Policies, Plans or Strategies:

The consideration of options for the appointment of auditors is consistent with the policy framework and budget and the achievement of Best Value.

3.2 Relevant Ward and other Members /Officers etc. consulted on this matter:

The Chairman of the Committee has been consulted.

3.3 Relevant legal powers, personnel, equalities and other relevant implications (if any):

3.3.1 The work of the external auditors is governed by the Code of Practice issued by the Audit Commission in accordance with the Audit Commission Act 1998 and the Local Government Act 1999.

3.3.2 Section 7 of the Local Audit and Accountability Act 2014 (the Act) 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.

3.3.3 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.

3.3.4 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.

3.4 Will decision(s) be carried out within existing finances and resources?

3.4.1 Yes. The Council holds a budget for audit fees with headroom for penalties and objections on top of the recently reduced Grant Thornton fees. External fees levels are likely to increase when the current contracts end in 2018.

3.4.2 The cost of establishing a local or joint Auditor Panel outlined in options 1 and 2 will need to be estimated should the sector led approach not be supported 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.

- 3.4.3 Opting-in to a national Sector Led Body (SLB) provides maximum opportunity to limit the extent of any increases by entering into a large scale collective procurement arrangement and would remove the costs of establishing an auditor panel.

3.5 Main Risk Management and Equality Impact Assessment Issues (if any):

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. Providing the LGA with a realistic assessment of our likely way forward will enable the LGA to invest in developing appropriate arrangements to support the Council.

4. **Relevant background/chronology of key events:**

- 4.1. 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 (CLG) 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.

- 4.2. There are 3 main options available to the Council: a stand-alone appointment, a joint procurement or opting in to a sector led body appointment. The advantages and disadvantages of each option are set out in Appendix 1.

- 4.3. The Council's current external auditor is Grant Thornton, this appointment having been made under a contract let by the Audit Commission. Following closure of the Audit Commission the contract is currently managed by Public Sector Audit Appointments Limited (PSAA), the transitional body set up by the LGA with delegated authority from the Secretary of State CLG. Over recent years we have benefited from a reduction in fees in the order of 50% compared with historic levels. The savings we have made by improving our working papers, timescales and responsiveness has been added to by savings achieved by the new nationally negotiated contracts with the firms of accountants and savings from the closure of the Audit Commission.

- 4.4. When the current transitional arrangements come to an end on 31 March 2018 the Council will be able to move to local appointment of its

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. The Council's current external audit fees are £314,168 per annum.

- 4.5. The scope of the audit will still be specified nationally, the National Audit Office (NAO) 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 as 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.

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**Jon Warlow – Strategic Director – Finance & Legal**

## Options for Appointing Auditors

### 1. Options for local appointment of External Auditors

- 1.1. There are three broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act):

#### **Option 1 To make a stand-alone appointment**

- 1.2. 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.

#### *Advantages/benefit*

- 1.3. 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*

- 1.4. Recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract is estimated by the LGA to cost in the order of £15,000 plus on going expenses and allowances
- 1.5. The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
- 1.6. 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**

- 1.7. 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 and the Council need to liaise with other local authorities to assess the appetite for such an arrangement.

### *Advantages/benefits*

- 1.8. The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
- 1.9. There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.

### *Disadvantages/risks*

- 1.10. 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 possibly only one elected member representing each Council, depending on the constitution agreed with the other bodies involved.
- 1.11. 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.
- 1.12. Early indications from a range of neighbouring authorities indicate a preference for opting in to the SLB arrangements.

### **Option 3 Opt-in to a sector led body**

- 1.13. In response to the consultation on the new arrangement the LGA successfully lobbied for Councils to be able to 'opt-in' to a Sector Led Body (SLB) appointed by the Secretary of State under the Act. An SLB 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*

- 1.14. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities
- 1.15. 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
- 1.16. Any conflicts at individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.

1.17. 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 LGA are considering setting up such a body utilising the knowledge and experience acquired through the setting up of the transitional arrangements.

*Disadvantages/risks*

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

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

## **FAQs issued by the Local Government Association**

### **Sector led body FAQs**

1. What is your timetable for setting up the body?

We have already set up the company we would like to see as the sector led body. We set up Public Sector Audit Appointments Limited (PSAA) to make audit appointments under the transitional arrangements following closure of the Audit Commission. To act as a sector led body PSAA will need to be specified as an Appointing Person by the Secretary of State under the Local Audit (Appointing Person) Regulations 2015 and PSAA is working towards achieving such a specification at present.

2. When will we need to make a commitment?

The date by which principal local government bodies will need to formally opt-in to a sector led appointing person arrangement is not yet finalised. The aim is to award contracts to firms by June 2017, giving 6 months to organise which firm is appointed to each individual authority before the 31 December 2017 deadline. In order to maximise the potential economies of scale from agreeing large block contracts with the firms and to manage auditor independence issues we need certainty about the volume and location of work we are able to offer as soon as is practical. Our provisional timetable suggests that we will need to start preparing tender documentation in September 2016 so ideally we will need to know by then which authorities are included.

3. Can we join after it has been set up or do we have to join at the beginning?

One of the main benefits of a sector led approach is the ability to negotiate lower fees with the firms as a result of being able to offer higher volumes of work. The greater number of participants we have signed up at the outset the better the economies of scale we are likely to achieve. This will not prevent authorities from joining the sector led arrangements in later years. However, in order to be in the best position to negotiate good rates for authorities we would encourage as many authorities as possible to commit by September 2016.



4. Will membership be free for existing members of the LGA?

There will not be a fee to join the sector led arrangements. The audit fees that opted-in bodies will be charged by the sector led body will cover the costs of appointing auditors. We believe that audit fees achieved through block contracts will be lower than the costs that individual authorities will be able to negotiate. In addition, by using the SLB councils will avoid having to do their own procurement and the legal requirement to set up a panel of independent members.

5. If No to (4) then any idea how much membership of this might be?

N/A

6. How will we be able to influence how the SLB and associated contracts are set up?

Local Government Association members will be able to feed in consideration of the setting up of the sector led body through the usual channels including contact with their Principal Advisors. The Improvement and Development Agency Board considered a report on the outline proposals in December 2015. In addition, we are happy to attend meetings and engage with individuals or groups of authorities on request to discuss the developing arrangements. We have not yet determined the full governance of the sector led arrangements and are considering the options, including how best to obtain stakeholder input.

7. Will there be standard terms and conditions?

The audit contracts between the SLB and the audit firms will require firms to deliver audits compliant with the NAO Code of Audit Practice.

8. What will be the length of the contract?

The optimal length of contract between the SLB and an audit firm has not been decided. We would welcome views on what the sector considers the optimal length of audit contract.

9. Will there be the opportunity of a 3 year contract with an option to extend for up to 2 years or something similar?

Please see answer to question 8.

10. In addition to the Code of Audit Practice requirements set out by the NAO will the contract be flexible to enable authorities to include the audit of wholly owned companies and group accounts?

Local Authority Group accounts are part of the accounts produced under the CIPFA SORP and are subject to audit in line with the NAO Code of Audit Practice and will continue to be part of the statutory audit.

Company audits are subject to the provisions of the Companies Act 2006 and are not covered by the current PSAA managed appointment arrangements. We will consider the role of the SLB in making such appointments as part of our planning and would welcome views on this.

11. How is it envisaged that the procurement will work?

12. Will Local authorities be able to seek information from providers and undertake some form of evaluation to choose a supplier?

13. Will the price be fixed with the LGA or will there be a range of prices?

14. If a range of prices will individual Council's be able to undertake a process seeking information and bids from providers and then evaluate their submissions based on response and price i.e. like call off contracts?

We have not yet finalised our detailed procurement proposals and there are a number of options being considered. We will share with you our proposals as soon as possible. The questions raised above are useful in helping us identify the issues that need to be addressed in the proposals