

COUNTY COUNCIL – 13 DECEMBER 2016

APPOINTMENT OF EXTERNAL AUDITORS

Report by the Chief Finance Officer

Introduction

1. This report sets out the proposals for appointing the external auditor to the County Council for the 2018/19 accounts and beyond, as the current arrangements only cover audits up to and including 2017/18. The auditors are currently working under a contract originally let by the Audit Commission and novated to Public Sector Audit Appointments (PSAA) following the closure of the Audit Commission in April 2015.
2. The Audit and Governance Committee has reviewed the requirements and options available for the appointment of external auditors, and concluded that having a sector-wide procurement conducted by PSAA is the preferred option. A sector-wide procurement will produce better outcomes and will be less burdensome for the Council than any procurement undertaken locally. More specifically:
 - The audit costs are likely to be lower than if the Council sought to appoint locally, as national large-scale contracts are expected to drive keener prices from the audit firms;
 - Without the national appointment, the Council would need to establish a separate independent auditor panel, which could be difficult, costly and time-consuming;
 - PSAA can ensure the appointed auditor meets and maintains the required quality standards and can manage any potential conflicts of interest much more easily than the Council;
 - Supporting the sector-led body will help to ensure there is a vibrant public audit market for the benefit of the whole sector and this Council going forward into the medium and long term.
3. A formal acceptance of the PSAA offer to opt in to a national scheme is required by March 2017; however, the Council is asked to take a decision at this meeting because there will be significant work required to administer either of the alternative options to ensure that an appointment is made by 31 December 2017 if the recommendation is not agreed.

Background

4. The Local Audit and Accountability Act 2014 (the Act) 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. In October 2015 the Secretary of

State for 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.

5. The Act also set out the arrangements for the appointment of auditors for subsequent years, with the opportunity for authorities to make their own decisions about how and by whom their auditors are appointed. Regulations made under the Act allow authorities to 'opt in' for their auditor to be appointed by an 'appointing person'.
6. 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. PSAA was originally established to operate the transitional arrangements following the closure of the Audit Commission under powers delegated by the Secretary of State. PSAA is an independent, not-for-profit company limited by guarantee and established by the LGA.
7. PSAA is inviting the County Council to opt in, along with all other authorities, so that PSAA can enter into a number of contracts with appropriately qualified audit firms and appoint a suitable firm to be the County Council's auditor.
8. The principal benefits from such an approach are as follows:
 - PSAA will ensure the appointment of a suitably qualified and registered auditor and expects to be able to manage the appointments to allow for appropriate groupings and clusters of audits where bodies work together;
 - PSAA will monitor contract delivery and ensure compliance with contractual, audit quality and independence requirements;
 - Any auditor conflicts at individual authorities would be managed by PSAA who would have a number of contracted firms to call upon;
 - It is expected that the large-scale contracts procured through PSAA will bring economies of scale and attract keener prices from the market than a smaller scale competition;
 - The overall procurement costs would be lower than an individual smaller scale local procurement;
 - The overhead costs for managing the contracts will be minimised through a smaller number of large contracts across the sector;
 - There will be no need for the Council to establish alternative appointment processes locally, including the need to set up and manage an 'auditor panel', see below;
 - The new regime provides both the perception and reality of independent auditor appointment through a collective approach; and
 - A sustainable market for audit provision in the sector will be easier to ensure for the future.
9. The County Council's current external auditor is Ernst and Young, this appointment having been made under a contract let by the Audit Commission. Following closure of the Audit Commission the contract was novated to PSAA, and over recent years authorities have benefited from a reduction in fees in the order of 55% compared with fees in 2012. This has

been the result of a combination of factors including new contracts negotiated nationally with the audit firms and savings from closure of the Audit Commission. The Council's current external audit fees are £109,958 per annum.

10. The proposed fees for the subsequent years cannot be known until the procurement process has been completed, as the costs will depend on proposals from the audit firms.
11. 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 audit firms will be eligible to compete for the work, 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.
12. Currently, there are only nine providers that are eligible to audit local authorities and other relevant bodies; all of these being firms with a national presence. This means that a local procurement exercise, as described immediately below, would seek tenders from these same firms, subject to the need to manage any local independence issues. Local firms could not be invited to bid.

Other options

13. If the Council did not opt in there would be a need to establish an independent auditor panel. In order to make a stand-alone appointment the auditor panel would need to be set up by the Council itself. The members of the panel must be wholly or a majority of 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 audit firm to award a contract for the Council's external audit.
14. Alternatively 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 would be required on the exact constitution of such a panel having regard to the obligations of each Council under the Act and the Council would need to liaise with other local authorities to assess the appetite for such an arrangement.
15. Neither of these options are recommended. Both these options would be more resource-intensive processes to implement and without the bulk buying power of the sector led procurement, would be likely to result in a more costly service. It would also be more difficult to manage quality and independence requirements through a local appointment process.

The invitation

16. Details relating to the invitation to 'opt in' to the national scheme are provided in an Appendix to this Report. In summary it 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 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.

The way forward

17. 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 early March 2017.
18. 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.

Risk Management

19. The principal risks are that the Council fails to appoint an auditor in accordance with the new frameworks or does not achieve value for money in the appointment process. These risks are considered best mitigated by opting in to the sector led approach through PSAA.

Legal implications

20. Section 7 of the Local Audit and Accountability Act 2014 requires a relevant Council 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 Council 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 Council is a local Council operating executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the Council under those arrangements;

21. Section 12 makes provision for the failure to appoint a local auditor: the Council must immediately inform the Secretary of State, who may direct the Council to appoint the auditor named in the direction or appoint a local auditor on behalf of the Council.
22. 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. In July 2016 the Secretary of State specified PSAA as the appointing person.

Financial and Staff Implications

23. 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.
24. If the national scheme is not used some additional resource may be needed to establish an auditor panel and conduct a local procurement. Until a procurement exercise is completed it is not possible to state what, if any, additional resource may be required for audit fees for 2018/19.

RECOMMENDATION

25. **The Council is RECOMMENDED to accept Public Sector Audit Appointments' (PSAA) invitation to 'opt in' to the sector led option for the appointment of external auditors for five financial years commencing 1 April 2018.**

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