



City of Westminster

Audit & Performance Committee Report

Committee	Audit and Performance Committee
Date:	24 th November 2016
Classification:	General Release
Title:	Arrangements for the Appointment of External Auditors from 2018/19 onwards
Wards Affected:	All
Key Decision:	This will be a key decision for Full Council
Financial Summary:	The financial implications for the Council are considered for each option, although full details of the cost of each option are not yet available
Report of:	Steven Mair, City Treasurer

1. Executive Summary

- 1.1. This report provides a briefing on the options for appointing an external auditor to the Council for the 2018/19 financial year onwards. The current arrangements cover up to and including the 2017/18 audits.
- 1.2. The Council's current external auditors, Grant Thornton UK LLP, are currently working under a contract originally let by the Audit Commission. This was novated to Public Sector Audit Appointments (PSAA) following the closure of the Audit Commission.
- 1.3. Regulations made under the Local Audit and Accountability Act 2014 allow authorities options for appointing an external auditor from 2018/19 onwards. They can opt-in for their external auditor to be appointed by an "appointing person", as defined in the Regulations. Alternatively, they can establish an auditor panel and conduct their own procurement exercise solely or in partnership with other authorities.

- 1.4. The briefing note outlines the options in more detail, along with an analysis of the benefits and risks to the Council with the intention of opting into a procurement being run by the PSAA under the “appointing persons” regime.

Background information, including policy context

- 1.5. 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.
- 1.6. 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. Given this, the position for the Council is that Grant Thornton UK LLP will be the external auditors until the completion of the audit of the 2017/18 accounts.
- 1.7. The Act also set out the arrangements for the appointment of external auditors after 2017/18, with the opportunity for authorities to make their own decisions about how and by whom their external auditors are appointed.
- 1.8. There are three options available to the Council in the appointment of an external auditor after 2017/18:
 - Option 1: The Council can opt-in to a sector led body that will negotiate contracts and make the appointment on behalf of all opted-in Councils.
 - Option 2: The Council can set up its own independent auditor panel and manage a procurement exercise to appoint its own external auditor.

It should be noted that the members of the panel must be wholly or a majority of independent members as defined by the Act. For this purpose, this would exclude current and former elected members or officers and their close family and friends. This means that elected members will not have a majority input to assessing bids and appointing an external auditor.
 - Option 3: The Council can join with other Councils to set up a joint independent auditor panel and participate in a joint procurement exercise to appoint an external auditor to the group.

As above, this will require the establishment of a panel which is wholly or majority independent. Further legal advice would be required on the exact constitution of the panel with regard to the obligations of each authority under the Act.

- 1.9. The background to Option 1 is that in July 2016, Public Sector Audit Appointments (PSAA) were specified by the Secretary of State as an appointing person (also referred to as a sector led body) under regulation 3 of the Local Audit (Appointing Person) Regulations 2015.
- 1.10. PSAA is an independent, not-for-profit company, limited by guarantee, which was established by the Local Government Association (LGA). It was originally established to operate the transitional arrangements following the closure of the Audit Commission under powers delegated by the Secretary of State.
- 1.11. PSAA has invited the Council to become an opted in authority in accordance with the Regulations. The closing date for opting-in is 9 March 2017. If the Council chooses not to opt-in at this time, this route for appointing an external auditor would then be closed to them until 1 April 2018, at which point the PSAA will allow other authorities to opt-in.
- 1.12. The decision to opt-in commits the Council to having their external auditor appointed to the PSAA for the next five consecutive years – this is referred to as the compulsory appointing period. The PSAA will therefore appoint an external auditor for all opted-in authorities for each of the five consecutive financial years beginning from 1 April 2018, unless the Secretary of State chooses to terminate the PSAA's role as the appointing person. The Secretary of State may only do so after first consulting opted-in authorities and the LGA.
- 1.13. The PSAA have established an advisory panel to support the development of the procurement strategy. This will provide feedback on proposals and maintaining communication with both PSAA and opted-in authorities to ensure the strategy reflects the needs of opted-in authorities within the constraints set out in legislation and in professional requirements.
- 1.14. In order to ensure high quality audits the PSAA will only contract with firms with a proven track record in undertaking public audit work, and will include obligations around quality in the tender evaluation criteria and contract terms. They will also ensure they maintain appropriate registration, liaising with them and the Financial Reporting Council (FRC) to detect quality concerns at an early stage.

Benefits of opting-in

- 1.15. Opting-in to this scheme could have several benefits for the Council:

- 1.15.1. Minimising the use of time and resources in the complexities of setting up an independent auditor panel; managing the procurement exercise and ensuring we achieve the best contractual arrangements to deliver on price and quality; monitoring the independence of the appointed external auditor for the duration of the contract; and managing the contractual relationship for the duration of the appointment.
- 1.15.2. It is expected that a large scale contract procured through PSAA will bring economies of scale and attract keener prices from the market than a smaller scale competition.
- 1.15.3. Although the Council would not avoid procurement costs by choosing the opt-in route, these would be expected to be lower than an individual smaller scale local procurement exercise, although these are not yet quantified (see paragraph 1.16.3)
- 1.15.4. Opting-in allows the Council to access economies of scale whilst avoiding the additional legal complexities of entering into a joint arrangement with other authorities, assuming there would be any appetite for such an arrangement with other Councils.
- 1.15.5. The Council will mitigate the risk of failing to appoint an external auditor in time or not achieving value for money in the appointment process.
- 1.15.6. During initial exploratory discussions with the PSAA, the Council has received assurance that the relationship with the PSAA will be consultative and that they will work closely with their opted-in authorities to ensure a successful appointment.
- 1.15.7. Specifically for the Council, the PSAA has agreed to be mindful of the fact that we have relatively recently changed external auditor in 2015/16, and would wish to minimise the disruption and workload increase involved in establishing a new relationship so soon.
- 1.15.8. In addition, our requirement for external auditors willing to work to our closing timetable will form some part of the procurement process, although they have been clear that tenders cannot be evaluated on this basis, as this is not a requirement for all opted-in authorities.
- 1.15.9. The PSAA scheme is explicit that they will endeavour to appoint the same external auditors to opted-in bodies involved in formal collaboration or joint working initiatives, if we consider that this will enhance efficiency and value for money. It should be noted that the

Council does not currently have the same external auditors as our tri-borough partners. Any gains from aligning this arrangement would have to be weighed against the costs of transition.

- 1.15.10. The scheme is also explicit that they will be flexible about changing the external auditor during the five year period if there is a good reason e.g. to accommodate new joint working arrangements or failure to deliver the required standard of service. This would provide the Council with the opportunity to remove a poorly performing external auditor without have to enter into contract termination processes and a re-tendering exercise.

Risks of opting-in

- 1.16. Whilst there are clearly benefits to the Council of opting-in, there are also some risks which have to be considered.
 - 1.16.1. Detailed terms and conditions of the opt-in arrangement are not yet available. Whilst the PSAA have put in place assurances around the opted-in authority's ability to provide feedback and replace an external auditor on reasonable grounds, this is still not within the Council's control. Close examination would have to be given to the Terms & Conditions of opting-in to the PSAA and clarifying whether we would be able to opt-out within the five year period in the unlikely event we deem it necessary.
 - 1.16.2. The Council's requirement for our external auditors to support our faster closing timetable will not be explicitly evaluated as part of the quality criteria of the tender, with the attendant risk that we are appointed an external auditor who cannot deliver the service we require. Should this happen the City Treasurer has already advised PSAA that the appointment will be challenged and an alternative auditor from the approved list sought. Should this not be confirmed as an option by PSAA then the Council will be recommended to procure its own auditors.
 - 1.16.3. The costs at this stage are not fully clarified. The costs of setting up and managing the PSAA will need to be covered by audit fees. Although the PSAA expect their annual operating cost to reduce once the scheme is operational, and have outlined the basic details of their charging mechanism. They intend to pool scheme costs and audited bodies in accordance with a fair scale of fees which have regard to size, complexity and audit risk. This will most likely be evidenced with reference to 2016/17 audit fees, but without fully understanding the

costs to be apportioned and the mechanism, we cannot yet have clarity on the costs of opting-in compared against the costs of running our own process.

Benefits of setting up an independent auditor panel for the Council either solely or as a joint arrangement with other authorities (Options 2 and 3)

- 1.16.4. Setting up an independent auditor panel would allow the Council to take maximum advantage of the new local appointment regime, albeit within of constraints of independence required by statute, and have local input into the decision.
- 1.16.5. This would also allow the Council to run its own procurement exercise, setting the quality and price criteria, and ensuring the right weight is given to factors that reflect its priorities. This would ensure that factors such as committing to our faster closing timetable are able to be taken into account in the tender evaluation.
- 1.16.6. The costs associated with establishing an independent auditor panel and running a procurement exercise could potentially be reduced by working in a joint arrangement with other authorities and sharing costs across the partnership. This could potentially also allow for the achievement of economies of scale in the tender prices.
- 1.16.7. The Council would not be opting-in to sector led arrangement which is only just being established and would be binding for five years.

Risks of setting up an independent auditor panel for the Council either solely or as a joint arrangement with other authorities

- 1.16.8. The risks of these options are in the main mitigated by the opting-in option.
- 1.16.9. Setting up an independent auditor panel and running a procurement exercise would have a significant cost to the Council in terms of time and resources. This could potentially be ameliorated by working in partnership, however, setting that up in itself is likely to be a time-consuming and costly exercise, with financial and legal implications to be considered.
- 1.16.10. The Council could fail to appoint an external auditor within the time required or fail to achieve value for money in the appointment.

1.16.11. The Council would also be committing to a significant workload in terms of monitoring the independence and quality of the external audit service and contractual arrangements.

1.16.12. Should there be contractual or quality issues with the external audit service, the Council would have to manage these on an individual basis whilst having to ensure other arrangements were in place. This is a function that will be managed by PSAA for all opted-in authorities.

2. Financial implications

2.1. If the decision is taken not to opt-in to the sector led body arrangement offered by the PSAA, a significant resource in terms of staff time and cost will be required to establish the auditor panel, conduct the procurement exercise, contract negotiation and monitoring.

2.2. It is not possible at this stage to quantify the additional resource that may be required for audit fees under any new arrangement. However, it is anticipated at this stage that opting-in to the PSAA will provide best value for money through:

- procuring an external auditor at a price which delivers on the economies of scale provided by the PSAA exercise
- spreading the running costs across all opted-in bodies

3. Legal implications

3.1. Schedule 3 of the Local Audit and Accountability Act 2014 states that the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the authority.

If you have any queries about this Report or wish to inspect any of the Background Papers please contact:

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BACKGROUND PAPERS

PSAA Prospectus - Developing the option of a national scheme for local auditor appointments (August 2016)