

## **Sandwell Metropolitan Borough Council**

**17 January 2017**

### **Appointment of External Auditors**

#### **1. Summary Statement**

- 1.1 Following the closure of the Audit Commission the Council will be responsible for appointing its own external auditors by 31 December 2017 for 2018/19 onwards.
- 1.2 There are a number of options to consider in order to put in place new arrangements in time to make an appointment of new external auditors by the statutory deadline of 31 December 2017.
- 1.3 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.
- 1.4 The Council's current external auditor is KPMG, this appointment having been made under at 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 the Council has benefited from a reduction in fees in the order of 50% compared with historic levels. This has been the result of a combination of factors including new contracts negotiated nationally with the firms of accountants and savings from closure of the Audit Commission.
- 1.5 When the current transitional arrangements come to an end on 31 March 2018 the Council will be required to appoint an external auditor. 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.

- 1.6 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, 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.
- 1.7 Having considered the advantages and disadvantages of the options available (as outlined in section 6 of this report), the preferred arrangements fall within Option 3, which requires the Council to opt-in to a sector led body for a Council appointment.

## **2. Recommendation**

- 2.1 That the Council, having considered the options set out in this report, approve Option 3, which is to opt-in to a sector led body on the basis that the Council requests the PSAA to take into account the Council's initial wish to extend the current external audit contract over the short to medium term, which is likely to be a two year extension.
- 2.2 If 2.1 is not feasible, then Council is requested to approve that the Authority opts-in jointly with the seven West Midlands Combined Authority councils.
- 2.3 If a joint agreement cannot be reached regarding the seven West Midlands Combined Authority councils, then Council is requested to approve a sole appointment of external auditors for 2018/19 onwards for a maximum of five years.

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### **3. Strategic Resource Implications**

- 3.1 There is an annual budget set aside to cover all external audit fees, including the main audit and grant certification work.

### **4. Legal and Statutory Implications**

- 4.1 The Local Audit and Accountability Act 2014 requires the Council to appoint an external auditor to audit its accounts.
- 4.2 Section 7 of the Act requires a relevant authority to appoint an auditor not later than 31 December in the preceding year.
- 4.3 Section 8 of the Act 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.
- 4.4 Section 17 of the Act 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.

### **5. Implications for the Council's Scorecard Priorities**

- 5.1 External Audit contributes to the achievement of the Council's Scorecard Priorities by issuing an audit opinion on the annual financial statements and assessing the Council's arrangements to secure value for money.

## **6. Background Details**

### **6.1 Options**

6.2 There are three options open to the Council under the Local Audit and Accountability Act 2014 (the Act):

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

6.3 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 (assuming there is no existing independent committee such as the Audit Committee that might already be suitably constituted).

#### **6.4 Advantages/benefit**

- 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.

#### **6.5 Disadvantages/risks**

- 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
- The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
- 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**

- 6.6 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.
- 6.7 Advantages/benefits
- The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
  - There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.
- 6.8 Disadvantages/risks
- 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 possible only one elected member representing each Council, depending on the constitution agreed with the other bodies involved.
  - 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.

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

6.9 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.

#### **6.10 Advantages/benefits**

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

#### **6.11 Disadvantages/risks**

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

6.12 There are three slight variations to this approach that could be implemented:

- When opting in to the SLB for continuity purposes, ask the PSAA to take into account our initial wish to extend the current external audit contract with KPMG over the short to medium term (which is likely to be a two year extension) whilst the Council tackles a number of big issues and challenges.
- A joint appointment for the seven councils in the West Midlands Combined Authority (WMCA). The appointment of a single external auditor will bring a consistent approach which will be advantageous particularly where there is joint working. A joint appointment should also realise better value for money.
- If agreement with the councils in the WMCA is not reached then the Council will make an appointment solely for itself.