



**Subject:** Options for Appointment of External Auditor  
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**Cabinet Member:** Cabinet Member for Finance  
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## 1 Purpose of Report

- 1.1 The Local Audit and Accountability Act 2014 (the Act) at Section 7 states that a “relevant authority must appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding financial year.” The current external auditor contract for Grant Thornton was extended for a further 12 months to include the accounts for 2017/18. Therefore for the Council the appointment of an auditor must be completed by 31 December 2017 for the audit year 2018/19.
- 1.2 This report sets out proposals for the Audit and Governance Committee to approve through which this appointment may be achieved. This aligns with the Audit and Governance Committee’s work programme and overall responsibility for governance, which includes monitoring the work and effectiveness of external audit on an ongoing basis and gaining assurance that best practice is being adopted.

## 2 Recommendations

- 2.1 Members of the Audit and Governance Committee are requested to consider and support the proposal for opting into the sector-led body, Public Sector Auditor Appointments Limited (PSAA), for the appointment of external audit services from 2017/18, as set out within Option 3 of this report (paragraphs 3.15 to 3.19), subject to final agreement by the Greater Manchester Association of Metropolitan Treasurers (GMAMT) and subsequent approval by RBC Full Council.

## 3 Background

- 3.1 The Local Audit and Accountability Act 2014 brought the Audit Commission to a close, 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 for Communities and Local Government 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. The current external auditor for the Council is Grant Thornton, this appointment having been made under a contract which was originally let by the Audit Commission.
- 3.2 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 Local Government Association (LGA) with delegated authority from the Secretary of State for

Communities and Local Government. When the current transitional arrangements come to an end on 31 March 2018 the Council will be able to move to a local appointment of its auditor. There are a number of routes by which this can be achieved, each with varying risks and opportunities.

- 3.3 Current audit fees are based on discounted rates offered by the firms in return for a 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.
- 3.4 The scope of the external audit will still be specified nationally by the National Audit Office (NAO) which is responsible for writing the Code of Audit Practice. All firms appointed to carry out the Council audit must follow these requirements.
- 3.5 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 is in progress and so the number of eligible and interested firms is not known at this stage but it is reasonable to expect that the list may include the top 10 or 12 firms in the country, including the Council's current external auditor. It is unlikely that small local independent firms will meet the required eligibility criteria.

#### **Options for Local Appointment of External Auditors**

- 3.6 There are three broad options open to the Council under the Act and new appointments for auditors need to be made by December 2017 regardless of which option is chosen.

#### **Option 1: Make a stand-alone appointment**

- 3.7 To make a stand-alone appointment, the Council will need to establish an independent Auditor Panel. The Panel must be made up of a majority of independent members as defined by the Act. Independent members for this purpose are independent appointees – for the Council this excludes all current and former elected members (or officers) and their close families and friends. This means that elected members will not have a majority input into the process for the assessment and appointment of the firm of accountants to provide the Council external audit. A newly established and independent Auditor Panel would be responsible for selecting the auditor.
- 3.8 This option allows the Council to take maximum advantage of the new local appointment regime and have local input to the decision; however, 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. In addition the Council would not benefit from reduced fees that may be available through joint or national procurement contracts.

#### **Option 2: Local joint procurement arrangements**

- 3.9 The Act enables the Council to join with other authorities to establish a joint independent Auditor Panel which would need to be constituted and made up of a majority, or of wholly independent members. Further advice will be required on the exact constitution of such a Panel having regard to the obligations of each body under the Act and as such the Council will need to liaise with other authorities to assess the appetite for this arrangement.
- 3.10 At present, eight of the ten GM district councils are audited by Grant Thornton and two are audited by KPMG. Given the level of collaboration, joint working and similar core functions across the Councils, there are likely to be benefits from including the ten districts in this procurement. In addition to this, an option could be extended to include health bodies at a later date, although it should be noted that they are currently working to a different timetable for appointments.

- 3.11 In addition the procurement exercise could be extended to include the GM Combined Authority (“GMCA”), Transport for Greater Manchester (“TfGM”), the GM Waste Disposal Authority (“GMWDA”), GM Fire and Rescue Service (“GMFRS”), the GM Police and Crime Commissioner’s Office (“GMPCC”), GM Police and New Economy). There are potential benefits from appointing the same auditor for this group of bodies, not just in terms of economies of scale but also in enabling the external auditor to obtain a fuller understanding of the audit requirements across GM local authorities.
- 3.12 Other advantages of this approach are that the costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities and therefore greater opportunity for negotiating economies of scale by being able to offer a larger combined contract value to the firms.
- 3.13 This option is not without risk. The decision making body will be further removed from local input. It is unlikely that elected members from each district or each GM Body would be represented on an independent auditor panel. However individual Audit Committees would still discharge their functions at district and GM levels; for example considering their own auditor reports; the statement and accounts; and governance arrangements.
- 3.14 There is a risk that accountancy and audit firms may decline to bid for a package of GM external audit work due to independence issues. A successful firm would be unable to undertake substantial values of advisory work, as to do so would be in contravention of professional standards, independence safeguards and terms of appointment established by the PSAA. Initial soft market testing has been undertaken and whilst some of the top tier firms have confirmed that this issue would likely preclude them from bidding, other firms have expressed interest in this procurement approach.

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

- 3.15 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. This body had been confirmed as Public Sector Audit Appointments Limited (PSAA). PSAA will 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. PSAA are a not-for-profit company owned by the LGA’s Improvement and Development Agency.
- 3.16 Under this approach, the option to join the appointing person scheme will be open to all principal local government authorities, including RBC and there is no fee to join these arrangements. The audit fees that opted-in bodies will be charged will cover the costs to PSAA of appointing auditors and managing the arrangements. 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. In addition, authorities will avoid the costs of their own procurement and management of contracts and also the requirement to set up an auditor panel with independent members.
- 3.17 The appointment process would not be ceded to locally appointed independent members but by a separate body set up to act in the collective interests of the ‘opt-in’ authorities. The independence of the auditor from each organisation is governed by an EU audit directive and is central to the whole process. The PSAA has confirmed that it will appoint the same auditor to bodies working together wherever possible, subject to independence considerations.
- 3.18 Under this option, individual elected members in Manchester and across GM will have less opportunity for direct involvement in the appointment process. However the ability to influence the process does exist through a stakeholder advisory panel whose members are drawn from representative organisations for councils, police and fire

bodies. The PSAA will run the tendering exercise and will evaluate bids and award contracts. However the PSAA will consult authorities on individual auditor appointments. Contracts will be awarded for a five year period.

- 3.19 The fee for the audited body that opts in will reflect the size, audit risk and complexity of the work required. PSAA will establish a system for setting the fee which is fair to all opted-in authorities. As a not-for-profit organisation, PSAA will be able to return any surpluses to opted in authorities after all costs have been met.

#### **Auditor Panel**

- 3.20 Unless opting into the Sector led body approach (option 3), there will be a requirement to establish an independent Auditor Panel, either specifically for the Council or in collaboration with partners. The Auditor Panel role is different to that of the Audit and Governance Committee. Its functions are to advise the Authority on:

- selection and appointment of the auditor;
- resignation or proposals to remove the auditor;
- adoption of a policy on non-audit services;
- maintenance of an independent relationship with the auditor; and
- any proposals to enter into limited liability agreements.

- 3.21 There is no specific reference in the Act to the Auditor Panel carrying out a contract oversight role but guidance from CIPFA does indicate this is a possible additional function that might be helpful.

- 3.22 It is anticipated that the Panel will benefit from support specifically from the Chief Executive, Chief Finance Officer/ Section 151 Officer, Head of Legal Services, Head of Internal Audit and the Head of Procurement either at AGMA or local level, depending on which option is chosen. It also acknowledged that there should be a relationship between the Panel and the relevant Audit Committee(s), who will receive updates and assurances arising from the work of the external auditor; and are also well placed to comment on the quality and performance of services provided through the contract. The Act does allow for the relevant Audit Committee to discharge the duties of the Auditor Panel but only if it meets the criteria set out below and that its role when acting as the Auditor Panel is clearly distinct from its role as the Audit Committee.

- 3.23 A key challenge for the Auditor Panel is to ensure appropriate appointments that meet the requirements of the Act. It is required that the Panel have at least three members but the majority, including the Chair, should be independent of the Council. It is permissible for Council elected members to be represented on the panel, but the majority of members and Chair are required to be independent. The definition of independence in the Act and supporting CIPFA guidance is explicit and allows little option other than through the advertisement and appointment of specific, external, independent members. Panel members will also be required to have the requisite skills and experience, which may not be readily identifiable or available given the specialist nature of the external audit contract and procurement processes.

- 3.24 If the Council progresses a single body appointment, it will be required to identify and appoint independent members for this process. The same principle will apply with a joint procurement but the collaborative option means that across the various GM level authorities, only one group of independent members would be required and this increases the likelihood of successfully identifying suitably skilled and experienced independent persons to sit on the panel. These are required to be identified through advertisement and supported by clear panel member role descriptions. The Council and any joint procurement partners will be required to set levels of allowances and expenses.

### **Preferred option**

- 3.25 The City Treasurer and counterparts in the other nine GM Councils (as GMAMT), are supportive of the proposal for opting into the sector-led body, PSAA (Option 3 above).
- 3.26 This option allows for economies of scale, given the 2015/16 combined external audit and grant certification fees of these bodies was £1.8m, to derive best value from the negotiated contract in the future. The view of GMAMT is that whilst there are clear benefits for the Police, Transport and Greater Manchester Combined Authority to all have the same auditor from 2017/18, thereby enabling the auditor to take a more strategic approach across the region as a whole, there was less of an issue for individual local authorities within AGMA to have the same auditor. This aligns with the current situation with all but two of the local authorities being audited by Grant Thornton, the other two by KPMG. Given all the concerns over independence issues, GMAMT also feel that to get one single auditor for all AGMA local authorities may prove problematic.
- 3.27 This approach will avoid the costs, and associated administrative effort, of RBC or even AGMA running their own procurement and management of contracts and also avoid the requirement to set up an auditor panel with independent members.

### **Next Steps**

- 3.28 The Council has until December 2017 to make an appointment. In terms of the proposal to opt in to the sector-led body, GMAMT are proposing to make a final decision to confirm this is the preferred option by their next meeting on 9 December. Thereafter the decision to opt in will need to be approved by RBC Full Council and confirmed with the PSAA by 9 March 2017 at the latest.
- 3.29 Further timescales proposed by PSAA include the following:
- Invite tenders from audit firms – by April 2017;
  - Award contracts – by 30 June 2017;
  - Consult on and make final auditor appointments – by 31 December 2017; and
  - Consult on, propose audit fees and publish fees – by 31 March 2018.

### **Recommendations**

- 3.30 Members of the Audit and Governance Committee are requested to consider and support the proposal for opting into the sector-led body, PSAA, for the appointment of external audit services from 2017/18, as set out within Option 3 of this report (paragraphs 3.15 to 3.19), subject to final agreement by GMAMT and subsequent approval by RBC Full Council.
- 3.31 Members will receive updates on progress of this development at future Audit and Governance Committee meetings.

## **4 Alternatives considered**

- 4.1 Consideration of all the available alternatives to the proposed approach is set out within Section 3 of this report. As such, no further alternatives are considered appropriate as this is a legislative requirement.

## **5 Financial Implications**

- 5.1 There are no significant financial implications arising from this report other than the focus on ensuring best value is derived from the appointment of external auditors in the future.

## **6 Legal Implications**

6.1 Aside from the fact that the proposals set out within this report are being put forward to ensure compliance with relevant legislation, there are no other legal implications arising from this report.

## **7 Personnel Implications**

7.1 There are no personnel implications arising from this report.

## **8 Corporate Priorities**

8.1 This report supports the Council's overall corporate objectives of ensuring that governance arrangements remain strong across the Council, particularly throughout this period of significant change.

## **9. Risk Assessment Implications**

9.1 All key risks associated with the proposal have been considered within Section 3 of this report.

## **10. Equalities Impacts**

### **10.1 Workforce Equality Impacts Assessment**

There are no workforce equality issues arising from this report.

### **10.2 Equality/Community Impact Assessments**

There are no equality/community issues arising from this report.

<b>Background Papers</b>	
<b>Document</b>	<b>Place of Inspection</b>
None	