



## Committee report

Committee	<b>FULL COUNCIL</b>
Date	<b>18 JANUARY 2017</b>
Title	<b>EXTERNAL AUDIT ARRANGEMENTS AFTER 2017-18</b>
Report of	<b>DIRECTOR OF FINANCE AND SECTION 151 OFFICER</b>

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### EXECUTIVE SUMMARY

1. This report sets out proposals for appointing the council's external auditor for the five financial years commencing 1 April 2018. The council's current arrangements continue to apply up to and including the 2017-18 audits under the terms of a contract let by the Audit Commission which was transferred to Public Sector Audit Appointments Limited (PSAA) following the closure of the Audit Commission.
2. At its meeting of 26 September 2016, the Audit Committee agreed to recommend to Full Council to opt-in to an approved collective procurement arrangement through Public Sector Audit Appointments Limited (PSAA) to assist with the appointment of an external auditor for the 2018-19 and subsequent accounts.
3. 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 (meeting as a whole).

### BACKGROUND

4. Under the Local Audit and Accountability Act 2014, the council is required to have an independent external audit of its financial statements, including those of the pension fund that also provides some assurance that the council takes reasonable actions to secure economy, efficiency and effectiveness in its use of resources. Historically the external auditor has been appointed by the Audit Commission.
5. Following the passing of the Local Audit and Accountability Act 2014, the Audit Commission was abolished on 31 March 2015. Its key functions were transferred to other bodies, and in relation to auditor appointments, PSAA, an independent company limited by guarantee incorporated by the Local Government Association took on the role.

6. Ernst & Young LLP (EY) are the council's existing external auditors under a national contract previously let by the Audit Commission and now managed by PSAA under transitional arrangements. This means that EY will continue to be the council's auditor until the completion of the 2017-18 audit and a new appointment will be need to be made by the council for 2018-19 and beyond.
7. By law an authority must make an appointment by the end of December prior to the year for which the audit is required, so the council will need to have found an auditor by 31December 2017.
8. The council, as a principal authority, needs to decide how its auditors will be appointed under the new requirements. The council may make its auditor appointment in one of the following ways:
  - Independent procurement exercise.
  - Collaborative procurement exercise in conjunction with other local authorities.
  - Take advantage of the national collective scheme currently being developed by PSAA.
9. If making the appointment itself, or in conjunction with other bodies, the council must consult and take into account the advice of its auditor panel on the selection and appointment of a local auditor. The constitution of the auditor panel is set out in Schedule 4 of the Local Audit and Accountability Act 2014, which states that it must consist of a majority of independent members (or wholly of independent members), and that it must be chaired by an independent member.
10. The schedule also sets out the very strict definitions of "independent", which includes that the panel member cannot have been a member or officer of the council, or any other authority or entity with which the council is connected, for the previous five years.
11. In July 2016, the Secretary of State for Communities and Local Government confirmed that Public Sector Audit Appointments Limited (PSAA) has been specified as an appointing person under the provisions of the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2015. This means that PSAA will make auditor appointments to relevant principal local government bodies that choose to opt into the national appointment arrangements, for audits of the accounts from 2018-19.
12. PSAA is inviting the council to 'opt in', along with all other local authorities, so that PSAA can enter into a number of contracts with appropriately qualified audit firms and appoint a suitable firm to be the council's auditor.

#### THE INVITATION AND NEXT STEPS

13. PSAA has now formally invited this council to 'opt in'.

14. In summary, the national opt-in scheme provides the following:
- The appointment of a suitably qualified audit firm for 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.
  - Ongoing contract and performance management of the contracts once these have been let.
15. 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 (meeting as a whole). The council then needs to formally respond to PSAA's invitation in the form specified by PSAA by early March 2017.
16. 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 each authority can make an appointment by the statutory deadline of December 2017.

### STRATEGIC CONTEXT

17. The external audit of the council, including the pension fund, represents a significant element of the council's overall corporate governance. It provides assurance that the council has implemented appropriate financial control systems and that the council's accounting records are kept up to date. It also provides assurance that:
- the statement of accounts has been prepared in accordance with relevant legislation;
  - that proper practices have been observed in the preparation of the statement of accounts, and that the statement presents a true and fair view; and
  - that the council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

## FINANCIAL / BUDGET IMPLICATIONS

18. The fees for the 2015-16 external audit of the council's accounts (including those of the pension fund) is as follows:

	2015-16 £
Isle of Wight Council	125,543
Harbours	2,511
Certification of claims and returns	14,711
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	142,765
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Isle of Wight Council Pension Fund	21,085
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19. The fee for the pension fund audit is met by the pension fund; these costs have already been accounted for in the running of the pension fund.
20. Opting-in to a national scheme provides maximum opportunity to ensure fees are as low as possible, while ensuring the quality of audit is maintained by entering into a large scale collective procurement arrangement. 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.
21. If the national scheme is not used some additional resource will 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.

## LEGAL IMPLICATIONS

22. The section 151 officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2015 to ensure that the council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the council by various statutes governing the conduct of its financial affairs.
23. Section 7 of the Local Audit and Accountability Act 2014 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 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 authority 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.

24. 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 authority to appoint the auditor named in the direction or appoint a local auditor on behalf of the council.
25. 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.
26. 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 (meeting as a whole).

### EQUALITY AND DIVERSITY

27. The council has a legal duty under the Equality Act 2010 to seek to eliminate discrimination, victimisation and harassment in relation to age, disability, gender re-assignment, pregnancy and maternity, race, religion, sex, sexual orientation and marriage and civil partnership.
28. Initial screening has indicated that there are no direct equality implications arising from implementing this decision.

### OPTIONS

29. Option 1: that the council establishes its own independent auditor panel and undertakes an independent procurement exercise. The panel must be made up of a majority or of wholly independent members and must be chaired by an independent member.
30. Option 2: that the council undertakes a joint procurement exercise with a group of other local authorities. This will require the formation of a joint independent auditor panel with those other authorities.
31. Option 3: that the council a) accepts Public Sector Audit Appointments Limited's invitation to "opt in" to the sector led option for the appointment of external auditors for the five financial years commencing 1 April 2018; and b) authorises the director of finance and section 151 officer to sign and return the notice of acceptance on behalf of the Isle of Wight Council.

### EVALUATION

32. Under option 1, if the council was to establish its own independent auditor panel and undertake its own local auditor appointment (subject to paragraphs 34 and 35 below), there is more likelihood that the auditor would reflect local requirements. Appointing the auditor locally would also give the council more control over the process and give it influence over the audit fee.

33. However, it is felt that these advantages are outweighed by the need to establish an auditor panel (as described in paragraphs 9 and 10 above), a time consuming and relatively costly procurement exercise, no economies of scale and limited purchasing power. At this time the costs of establishing an independent auditor panel and the costs of the procurement exercise are unknown.
34. 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
35. 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 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.
36. Under option 2, undertaking a joint procurement exercise with a group of other local authorities, possibly neighbouring authorities, again there is more likelihood that the auditor would reflect local requirements (subject to paragraphs 34 and 35 above). Procurement costs would be shared, although at this stage it is not possible to establish the magnitude of these costs. The council would have some control over the process and an opportunity to influence the level of fees.
37. Again it is felt that these advantages are outweighed by the need for an auditor panel (as described in paragraphs 9 and 10 above) to be established jointly with other bodies in the joint arrangement and additional time for planning and collaboration with other audited bodies would be required. There would also be additional time required for obtaining ministerial approval for the authorities within the joint arrangement to be given the power to appoint auditors.
38. Under option 3, accepting PSAA's invitation to "opt in" to the sector led option for the appointment of external auditors has the following advantages:
  - 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.
  - The new regime provides both the perception and reality of independent auditor appointment through a collective approach.
  - A sustainable market for audit provision in the sector will be easier to ensure for the future.
39. As noted in paragraph 11 above, the Secretary of State for Communities and Local Government has already confirmed that PSAA has been specified as such an appointing person for option 3.
40. Should the council fail to appoint a local auditor in accordance with the Local Audit and Accountability Act 2014, it must notify the Secretary of State, who may then either direct the council to appoint a specific auditor or may appoint an auditor on behalf of the council. Should this happen, then there is a good likelihood that the auditor would not reflect local requirements, and the council would have very little influence over the level of fees charged.

#### RECOMMENDATION

41. That the council:
- a) accepts Public Sector Audit Appointments Limited's invitation to "opt in" to the sector led option for the appointment of external auditors for the five financial years commencing 1 April 2018; and
  - b) authorises the director of finance and section 151 officer to sign and return the notice of acceptance on behalf of the Isle of Wight Council.

#### BACKGROUND PAPERS

42. Report to Audit Committee 26 September 2016 "External Audit Arrangements After 2017-18"  
<https://www.iwight.com/Meetings/committees/Audit%20Committee/26-9-16/PAPER%201.pdf>

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