

**Police and Crime Commissioner for Hampshire and
Hampshire Constabulary**

Item: 6

Joint Audit Committee

7 February 2017

Local Appointment of External Auditors

Report of:

Richard Croucher, CFO to the Chief Constable

Carolyn Williamson, CFO to the Police and Crime Commissioner

1. Purpose

- 1.1 This report summarises the changes to the arrangements for appointing External Auditors following the closure of the Audit Commission and the end of the transitional arrangements at the conclusion of the 2017/18 audits.
- 1.2 The Police & Crime Commissioner (PCC) and Chief Constable (CC) will need to consider the options available and put in place new arrangements in time to make a first appointment by 31 December 2017. However, if the decision is to procure external audit services via Public Sector Audit Appointments (PSAA), the PCC and CC must opt in by 9 March 2017.
- 1.3 The other partners within the Shared Services environment, Hampshire County Council (HCC) and Hampshire Fire and Rescue Authority (HFRA), have already opted into the PSAA arrangement.

2. Recommendations

- 2.1 The recommendation of the Chief Finance Officers is that the appointment of external auditors is via the PSAA as this is expected to offer the best value for money and key partners including Hampshire County Council and Hampshire Fire and Rescue Authority have already opted into this approach.
- 2.2 The Joint Audit Committee are requested to consider the options and provide their feedback to the Police and Crime Commissioner and Chief Constable on the options available so that the PCC and CC can take the decision.
- 2.3 The three options available for appointing external auditors are:
 - a) Opting into the PSAA national sector led approach
 - b) Establishing a stand-alone Auditor Panel to make the appointment on behalf of the PCC & CC

- c) Commencing work on exploring the establishment of local joint procurement arrangements with neighbouring organisations.

3. Background

- 3.1 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 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.
- 3.2 The PCC and CC current external auditor is Ernst & Young LLP, this appointment having been made under 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 Communities and Local Government. Over recent years we have benefited from reduced fees (compared with historic levels) due to a combination of factors including new contracts negotiated nationally and savings from closure of the Audit Commission.
- 3.3 When the current transitional arrangements come to an end on 31 March 2018 the PCC and CC will be able to move to local appointment of the external auditor. There are a number of routes by which this can be achieved, each with varying risks and opportunities. 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.
- 3.4 The scope of the audit will continue to 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 PCC's and CC'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.

4. Options for local appointment of External Auditors

- 4.1 There are three broad options open to the PCC and CC under the Local Audit and Accountability Act 2014 (the Act):

Option 1 - To make a stand-alone appointment

- 4.2 In order to make a stand-alone appointment the PCC and CC will need to set up an Auditor Panel.
- 4.3 An auditor panel must consist of at least a majority of independent members, and must be chaired by an independent member.
- 4.4 The auditor panel is in place to advise the relevant authority on maintaining an independent relationship with its auditor and on selection and appointment of its auditor. The Act requires the relevant authority to publish advice from its auditor panel.
- 4.5 The authority is required, on receiving a request from the auditor panel, to provide any information held by the authority that is of relevance to the auditor panel's work. The auditor panel may require a member or officer of a relevant authority to attend a meeting of the panel to answer questions.
- 4.6 A relevant authority must consult its auditor panel and take its views into account when selecting and appointing an auditor.
- 4.7 To support transparency of the appointment, the relevant authority must publish a notice within 28 days of making the appointment that: states it has made the appointment; the term of that appointment; who the appointed auditor is; sets out the auditor panel's advice; and if that advice has not been followed, the relevant authority's reasons for not following it.

Advantages/benefit

- 4.8 Setting up an auditor panel allows the PCC and CC to take maximum advantage of the new local appointment regime and have local input to the decision.

Disadvantages/risks

- 4.9 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 (an element of these costs will already feature within existing budgets should the Joint Audit Committee be determined as the appropriate forum to host the 'audit panel').
- 4.10 The PCC and CC will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.

Option 2 - Set up a Joint Auditor Panel/local joint procurement arrangement

- 4.11 The Act enables the PCC and CC to join with other local bodies to establish a joint auditor panel. The panel 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 local body under the Act and the PCC and CC need to liaise with other local bodies to assess the appetite for such an arrangement. It would not be possible to form a panel with HCC or HFRA as they have already opted into the PSAA arrangement.

Advantages/benefits

- 4.12 The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
- 4.13 There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.

Disadvantages/risks

- 4.14 The process will be further removed from local input, with potentially only one representative from each local body, depending on the constitution agreed with the other bodies involved.
- 4.15 The choice of auditor could be complicated where individual organisations 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 local body. 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 the PCC or CC then the PCC and CC 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

- 4.16 In response to the consultation on the new arrangement the LGA successfully lobbied for local bodies 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.
- 4.17 In July 2016, the Secretary of State for Communities and Local Government specified PSAA as an appointing person under regulation 3 of the Local Audit (Appointing Person) Regulations 2015. This means that PSAA can make auditor appointments from 2018/19 to relevant principal authorities (which includes both the PCC and CC) that choose to opt into its arrangements; effectively this means that PSAA are the sector led body
- 4.18 The date by which principal authorities will need to opt into the appointing person arrangement is 9 March 2017. PSAA have set out that their aim is to award contracts to audit firms by June 2017, giving six months to consult with authorities on appointments before the 31 December 2017 deadline. The PCC and CC have each received an invitation to opt in.
- 4.19 A prospectus has been issued by PSAA which provides further information on their appointment and their proposals moving forward, and this is attached as appendix one.

Advantages/benefits

- 4.20 The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities

- 4.21 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
- 4.22 Any conflicts at individual local bodies would be managed by the PSAA who would have a number of contracted firms to call upon.
- 4.23 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' local bodies. The PSAA have set up such a body utilising the knowledge and experience acquired through the setting up of the transitional arrangements.
- 4.24 As HCC and HFRA have already opted in, a single audit firm could audit the accounts for the PCC, CC, HCC and HFRA. Efficiencies have already begun to be achieved through sharing auditors as the majority of key financial systems operate in the same way within the Shared Services partnership. This saves time for the auditors, which will be helpful with faster closedown and also take up less of our staff time to service the demands of the audit.

Disadvantages/risks

- 4.25 Less opportunity for direct involvement in the appointment process other than through the PSAA and/or stakeholder representative groups.
- 4.26 In order for the PSAA to be viable and to be placed in the strongest possible negotiating position the PSAA will need local bodies to indicate their intention to opt-in before final contract prices are known.

5. The way forward

- 5.1 The PCC and CC have until December 2017 to make an appointment. In practical terms this means one of the options outlined in this report will need to be in place by spring 2017 in order that the contract negotiation process can be carried out during 2017.
- 5.2 Greatest economies of scale will come from the maximum number of local bodies acting collectively and opting-in to PSAA. In order to the strengthen the PSAA's negotiating position and enable it to more accurately evaluate the offering the PCC and CC responded positively when asked to consider whether it was interested in the option of opting in to a PSAA. Such response was made without obligation and does not form a binding commitment. A formal decision to opt-in will be required by 9 March 2017.

6. Risk Management

- 6.1 There is no immediate risk to the PCC or CC, however, early consideration of their preferred approach will enable detailed planning to take place so as to achieve successful transition to the new arrangement in a timely and efficient manner.

7. Legal implications

- 7.1 Section 7 of the Local Audit and Accountability Act 2014 (the Act) 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 authority must consult and take account of the advice of its auditor panel on the selection and appointment of a local auditor.

- 7.2 Section 12 makes provision for the failure to appoint a local auditor: the authority 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 local bodies.
- 7.3 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.

8. Financial Implications

- 8.1 An annual budget already exists for external audit. The expectation is that appointment via the PSAA would result in costs comparable to the existing revenue budget. The other options are likely to require an increase in budget due to fee prices from auditors and to a lesser extent the additional governance costs.

9. Conclusion and Next Steps

- 9.1 The PCC and CC will want to take into the account the views of the Joint Audit Committee and other contributors before making a decision by the 9 March 2017.