

## **APPENDIX A**

### **External Audit Contracts**

#### **Purpose of report**

For decision

#### **Summary**

This report sets out the key issues that need to be considered in relation to the creation of a sector led body to manage external audit contracts for local government.

#### **Recommendation**

1. Note that the LGA have been successful in lobbying government to bring forward amendments to the Bill to allow for a form of national procurement.
2. To decide whether the LGA should pursue the option of a sector led body led by the LGA to procure external audit on behalf of councils that opt-in.
3. To decide whether, in light of 1, that the LGA should pursue with government the option of a sector led body being the interim body following the closure of the Audit Commission.

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## **BACKGROUND**

1. The Local Audit and Accountability Bill was introduced in the House of Lords in July 2013. Amongst other things, it will enable Councils to appoint their own auditor. However, this comes at a potential additional cost to councils. Councils will also need to establish an Independent Audit Appointments Panel which must be chaired by an independent person and have a majority of independent people sitting on it. At the moment the Audit Commission appoint auditors to councils and set the fees for those appointments. The earliest date that Councils would be able to make their own appointments is for contracts starting in 2017.
2. The LGA in its evidence to the CLG pre-legislative scrutiny committee argued that the Bill should also allow the option for Councils to secure their external auditors through some form of national procurement process. This was on the basis that there was a strong body of evidence to indicate that for most councils and for the sector overall this would be the most effective way of achieving the best price. Individual appointments will also involve additional procurement costs and this will also increase audit firms' tendering costs which in turn is likely to be passed on to local public bodies.
3. Councils have also been clear in their responses to the draft Bill and the call for evidence from the scrutiny committee that the requirement that councils should only be able to appoint auditors following a recommendation from an independent 'auditor panel' with a majority of independent members and an independent chair is unnecessary and impractical.
4. The LGA have lobbied Ministers, initially with a view to seeking an amendment to the Bill which would create the flexibility of national procurement to continue to be an option on a mandatory basis.
5. Ministers have indicated that they are not willing to entertain a mandatory option but would be willing to consider an "opt-in" option around national procurement being delivered through a sector led body. Following further lobbying by the LGA, Ministers have indicated that they will bring forward amendments when the Bill reaches the Committee stage of the House of Commons (autumn 2013) to allow the option for councils to opt-in to a national procurement option.
6. The Local Audit and Accountability Bill when passed will also formally abolish the Audit Commission. The current timescales suggest that the Audit Commission would close on 31 March 2015. This means that there will need to be an interim body that will be required to undertake certain functions between the anticipated closure of the Commission and the introduction of new audit arrangements in 2017 or indeed 2020 if the external audit contracts were extended to 2020. The LGA support the extension of the external audit contracts to 2020 given this would lock in for a further 3 years the current prices.

## **SECTOR LED BODY**

7. There are a number of key issues that need to be considered and addressed for any sector led body created to procure and manage external audit including:

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- a) the duties, powers and responsibilities of the body including which public bodies should be covered
  - b) legal form and governance issues
  - c) resourcing and financial risk
8. The issues are then compounded by the relationship with the interim body that is referred to in para 6 above.

Duties, Powers

9. The legal and practical functions of a sector-led body must include a mixture of powers, duties and practical functions. This will need to include the ability to appoint auditors and to set the fee levels. There is likely to be an expectation that the body would need to have specific measures in place to safeguard the interests of audited bodies and to provide assurances to government.

Legal form and Governance

10. Consideration will need to be given to the legal status of any sector-led body and its relationship with the LGA. The formal status will need to enable it to have the duties and powers referred to above.
11. The sector led body could be led by the LGA. Other options could include one of the existing procurement organisations known collectively as the PRO 5 group; or a lead council. There are potential advantages to the body being led by the LGA. It would be a service that would be made available to all councils and add to our suite of offers. It would bring in an additional form of income to the LGA. There are some potential links between some aspects of the new body and the LGA's work on sector led improvement.
12. If a formal company is required then use could be made of an existing company from the LG group including Local Government Information House or the IDeA Board or a new company may need to be established.
13. The body is likely to need to provide a level of assurance of its governance and operating arrangements, particularly mechanisms for ensuring independence and managing conflicts of interest. Given it will be exercising statutory functions it will have to be publicly accountable for these activities. The body will also require information from other bodies such as the Financial Reporting Council and Recognised Supervisory Bodies.

Resourcing and Financial Risk

14. In line with current practice and proposals for the smaller bodies sector, it is expected that the running costs for the sector-led body would be met via a retained portion of the audit fees. During the transitional period (2015-2017), the financial risk is very low as the contracts have been awarded and a fee arrangement is in place. Although, if there was an issue with one or more of the contracts with any of the firms who currently carry out the work, the body would need to deal with this which could involve additional costs over and above those currently planned for. We are aware from informal discussions with the Audit Commission that they have set aside some reserves which would potentially be available for the sector led body and therefore could be used to offset any financial risk.
15. The financial risk changes once the provisions of the Local Audit and Accountability Bill around local appointment come into effect. At this point Councils would be able to choose to appoint locally. Whilst there are considered to be strong financial benefits (central procurement is estimated to save councils overall in the region of £250m over a five year period compared to every council appointing individually) to councils choosing to opt into a central procurement process, this is clearly untested. In addition, Councils would not be required to establish an independent audit panel if they opted into the national arrangement.
16. For such an approach to be viable, the sector-led/LGA body would need to know who would be likely to participate. Given the size of the local government audit market it is estimated that even a minimum 70 per cent take-up would be sufficient to secure very competitive prices.
17. Soundings are being taken currently with councils through the Principal Advisors and a formal exercise will be carried out over the next few months to gauge interest if it is decided to pursue the sector led body option.
18. **It is recommended that the LGA agree to pursue the option of a sector led body led by the LGA to procure external audit on behalf of councils that opt-in.**

**INTERIM BODY**

19. As referred to in paragraph 6, an interim body will be required from the closure of the Commission to the introduction of the new audit arrangements from 2017. The primary function of the body will be to manage the various contracts with audit firms for the provision of audit and related services for principal and smaller bodies. Provision will need to be made to novate the contracts, and the rights and obligations that flow from them, to a successor body, which will then manage them over the period until they expire two and a half years later, or to 2020 if they are extended.

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20. In order to successfully manage these contracts, the interim body will need to undertake a range of functions and retain statutory powers under the Audit Commission Act 1998.
21. There are some other audit-related activities currently undertaken by the Commission which may also be transferred to another body in the interim period. These include:
  - a) value for money profiles
  - b) financial ration tools
  - c) fraud surveys and tools
  - d) activities to support the smaller bodies regime

Options

22. Discussions with civil servants to date suggest there are three options for managing the Commission's audit contracts after 2015:
  - a) a specialist unit or agency within DCLG or another government department
  - b) a stand-alone agency or public body
  - c) a hybrid solution, where the statutory powers would be transferred to DCLG, another government department or a stand-alone government agency, but their operation in practice would be delegated to a sector led body.
23. CLG have indicated to date that they can see a number of advantages in the interim body being the sector led body that is being considered as part of the longer term option.
24. If the LGA wish to establish a sector led body to procure external audit post 2017 for councils who wish to go down this route, it would be beneficial if the sector led body could also be the interim body. This would mean that there would only be one transfer of the skills and expertise from the Audit Commission to another body and for the interim period between 2015 and 2017 it would provide the sector led body with 2 years' experience of managing the contracts and building up the interest in councils opting into future national procurement.
25. **Therefore it is recommended that the LGA pursue with government the option of a sector led body being the interim body following the closure of the Audit Commission. The body would manage the current external audit contracts and taken on responsibility for the value for money tools.**

**SCOPE OF INTERIM BODY AND SECTOR LED BODY**

26. The Audit Commission contracts cover a wide range of bodies outside local government including Police, Fire, and NHS bodies and a large number of smaller bodies.

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27. Smaller bodies are those with annual income, or expenditure, of not more than £6.5 million. There are currently some 10,000 'small' bodies (such as parish and town councils, parish meetings and internal drainage boards and they are subject to a different contract from the external audit contracts in place for principal authorities and the NHS bodies etc.
28. The current contracts which cover local authorities, police, fire and the NHS bodies cannot be separated by sector. Therefore, the interim body would need to take on responsibility for all the current areas and not just local government. For these reasons, any sector led body during the interim period would need to involve interested parties from the other sectors and potentially for them to be part of any governance model. Initial indications from other interested government departments is that their preference is likely to be for the interim body to be hosted by another government department but they do not rule out the option of the sector led body acting as the interim body.
29. In the longer term (post 2017) there would need to be a decision taken as to whether the sector led body should act on behalf of police and NHS bodies as well as local government, if there was a view from these sectors that it would be helpful to have such an option.

#### **CONCLUSION AND NEXT STEPS**

30. The LGA have been successful in making the case for changes to be made to the Local Audit and Accountability Bill. These changes will provide the option for councils to opt-in to a sector led body which could procure external audit for them in the future.
31. There are significant benefits to Councils if the LGA pursue the option of a sector-led body including:
  - a) Savings estimated at £250m over a five year period in audit fees
  - b) The requirement for each council to establish an independent Audit Appointment Panel would not be needed
  - c) Councils would not need to carry out separate procurement exercises
32. If it's agreed that a sector led body should be established then it makes sense that such a body should also be the interim body.

#### **LEGAL IMPLICATIONS**

33. The key legal and governance implications arising from a sector led body is identified in the report. If the decision is to proceed with this approach it will be important that these are fully addressed in the setting up including in discussions with CLG on the appropriate statutory powers that will be required.