



Leicester
City Council

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All

FORWARD TIMETABLE OF CONSULTATION AND MEETINGS:

Audit & Risk Committee

15 June 2016

Annual Approval of the Policy for Engagement of External Auditors for Non-Audit Work

Report of the Director of Finance

1. Purpose of Report

- 1.1. To seek the Audit and Risk Committee's approval of the *Policy for Engagement of External Auditors for Non-Audit Work*.

2. Recommendations

- 2.1. The Committee is recommended to approve the attached *Policy for Engagement of External Auditors for Non-Audit Work*.

3. Summary

- 3.1. At its meeting, on 1 July 2015, the Audit and Risk Committee approved the *Policy for Engagement of External Auditors for Non-Audit Work*. This was the third occasion this policy had been presented to this Committee.
- 3.2. The Audit and Risk Committee's Terms of Reference (and this policy itself) require this policy to be reviewed and approved annually.

4. Report

- 4.1 The policy for Engagement of External Auditors for Non-Audit Work is attached at **Appendix 1**. The purpose of this is:
 - To protect the Council's interests by ensuring that any such work is properly arranged and approved
 - To protect the external auditor's independence and objectivity.
- 4.3 This policy does not replace the Council's existing Procurement processes, but adds an extra layer of security into that process where the External Auditors are concerned. The Policy outlines the approval processes and corporate reporting mechanisms that will be put in place for any non-audit work that the External Auditors are asked to perform.

- 4.4 The role of the Committee in the approval process for non-audit work by the external auditor is included in the Terms of Reference for the Committee. These are also reviewed and approved annually.
- 4.5 The policy has been reviewed and there are no changes proposed to this policy this year (as last year).
- 4.6 The Committee are advised that there was no work undertaken by KPMG in the past Financial Year that was not directly linked to their audit.

5. FINANCIAL, LEGAL AND OTHER IMPLICATIONS

5.1. Financial Implications

None specific beyond the statutory duties to maintain effective arrangements for financial administration, prepare and publish financial statements and submit them for audit.

5.2. Legal Implications

KPMG’s responsibilities as the Council’s external auditors are set out in the Audit Commission Act 1998 and the Audit Commission’s *Code of Audit Practice*. The Council’s requirements for preparing and publishing its financial statements and annual governance statement, which are subject to external audit, are set out in the Accounts and Audit (England) Regulations 2011.

6. Other Implications

| Other Implications | Yes/No | Paragraph or references within the report |
|-------------------------------|--------|---|
| Equal Opportunities | No | |
| Climate Change | No | |
| Policy | No | |
| Sustainable and Environmental | No | |
| Crime and Disorder | No | |
| Human Rights Act | No | |
| Elderly/People on Low Income | No | |
| Corporate Parenting | No | |
| Health Inequalities Impact | No | |
| Risk Management | Yes | The report concerns the Council’s governance and assurance processes, a purpose of which is to give assurance that risks are being managed appropriately by the business. |

7. Report Author

Tony Edeson, Head of Internal Audit and Risk Management – 37 1621

Policy for Engagement of External Auditors for Non-audit Work

1. Introduction and purpose of this policy

It is important that the independence of our external auditors in reporting to those charged with governance and to management of Leicester City Council (the Council), does not appear to be compromised but equally the Council should not be deprived of expertise where it is needed and can be leveraged from KPMG as a whole.

This policy therefore seeks to set out what threats to audit independence theoretically exist and thus provides a definition of non-audit work which can be shared by the Council and KPMG. It then seeks to establish the approval processes and corporate reporting mechanisms that will be put in place for any non-audit work that KPMG is asked to perform.

2. Threats to independence

The Institute of Chartered Accountants in England and Wales sets out threats to independence as:

| | |
|---------------|--|
| Self interest | Where an interest in the outcome of their work or in a depth of relationship with the Council may conflict with the auditors' objectivity |
| Self-Audit | where the auditors may be checking their own colleagues work and might feel constrained from identifying risks and shortcomings |
| Advocacy | may be present in an engagement but could become a threat if an auditor becomes an advocate for an extreme position in an adversarial matter |
| Familiarity | where the level of constructive challenge provided by the auditor is diminished as a result of assumed knowledge or relationships that exist |

3. Defining types of non-audit work and the associated approval process

In order to provide the Council with a transparent mechanism by which non-audit work can be reviewed and progressed without too great an administrative burden falling on the Council, the following three categories of work have been agreed as applying to the professional services available from KPMG:

3.1. *Statutory and audit related work not requiring Audit and Risk Committee approval*

There are certain projects where the work is clearly audit related and the external auditors are best placed to do the work e.g. acting as agents to the Audit Commission for grants certification work.

Policy for Engagement of External Auditors for Non-audit Work

It is proposed that such assignments do not require Audit and Risk Committee approval. However, recognising that the level of non-audit fees may also be a threat to independence, a limit on individual fees of £97,200 is set, above which prior Audit and Risk Committee approval should be sought for such work.

3.2 *Audit related and advisory services requiring prior Audit and Risk committee approval*

There are projects and engagements where the auditors are best placed to perform the work:

- Due to their network within and knowledge of the business (e.g. taxation advice, due diligence and accounting advice);
- Due to their previous experience or market leadership.

It is proposed that prior Audit and Risk Committee approval is sought for projects of this nature.

3.3 *Projects that are not permitted*

There are some projects that are not to be performed by the external auditors. These projects represent a real threat to the independence of the audit team such as where the external auditors would be in a position where they are auditing their own work (for example, systems implementation).

The Audit and Risk Committee is responsible for approving all non-audit work undertaken by the external auditors and reporting any instances to the Council. These proposed categories of non-audit work along with the related approval levels are set out below. More detail on each type of work is set out in Appendix A.

For the avoidance of doubt, seeking approval from the Audit and Risk Committee involves the business sponsor of the proposed work obtaining a proposed scope and fee estimate from KPMG before the work commences. If the fee exceeds the proposed limits or falls into a category of work that requires approval, details of the scope and fee proposal should be submitted to the Audit and Risk Committee Chairman and Director of Finance. If approved, the project should be logged by the Audit and Risk Committee secretary to be raised at the next Audit and Risk Committee meeting in order that a schedule of non-audit fees can be maintained and Council updated.

In cases where it is undecided which category services fall into they will default to the category that requires Audit and Risk Committee approval and be expected to take that route until such as time as this policy is reviewed and updated by the Audit and Risk Committee.

Policy for Engagement of External Auditors for Non-audit Work

4. Reviewing and updating this policy

KPMG will include within our annual ISA 260 report (report to those charged with governance) an appendix that summarises any additional work that they have performed for the Council and a review of the effectiveness of this policy.

The Audit and Risk Committee will formally agree on an annual basis that it is content with the structure, content and operation of this policy.

Examples of Work Types

The table below sets out examples of the different work types that could be requested from KPMG. As it would not be practical to consider all the services provided by KPMG we have documented the characteristics that drive the classification of services into the different work steams. This table is intended to provide illustrative examples of how the implementation of this policy would be approached should the Council request assistance from KPMG.

| | Statutory and audit related (Not requiring Audit and Risk Committee approval, unless fee is in excess of £97,200) | Audit and assurance related and non-audit advisory services (Sensitive projects requiring referral without de minimis) | Projects that are not permitted |
|--|---|--|---|
| Characteristics | <ul style="list-style-type: none"> Advice on areas core to the financial statements audit | <ul style="list-style-type: none"> Requiring independent objective assessment of information or procedures Staff secondments Other advisory services | <ul style="list-style-type: none"> Participation in management |
| Acquisitions / Disposals | <ul style="list-style-type: none"> Accountants reports Reporting on financial assistance Audit of carve out financial statements | <ul style="list-style-type: none"> Due diligence and related advice Completion accounts audit Agreement of price adjustment as a result of completion accounts Advice on integration activities Preparation of forecast of investment proposals | |
| Internal Audit and Risk Management Services | <ul style="list-style-type: none"> None | <ul style="list-style-type: none"> Provision of specialist skills / training Advice on methodology and systems Co-sourcing Advice and design of policies, systems or procedures. | <ul style="list-style-type: none"> Full outsourcing Systems implementation |
| Taxation | <ul style="list-style-type: none"> None | <ul style="list-style-type: none"> Preparation of draft returns Submission of returns and correspondence with tax authorities Advice on tax matters Transfer pricing Valuation for the purposes of taxation | <ul style="list-style-type: none"> Preparation of accounting entries for tax Handling taxation payments |

Examples of Work Types

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|---------------------------|--|--|---|
| General Accounting | <ul style="list-style-type: none"> • None | <ul style="list-style-type: none"> • Advice on accounts preparation and application of accounting standards • Training for accounting and risk management projects • Booking keeping services | <ul style="list-style-type: none"> • Preparation of accounting entries • Preparation of financial information |