

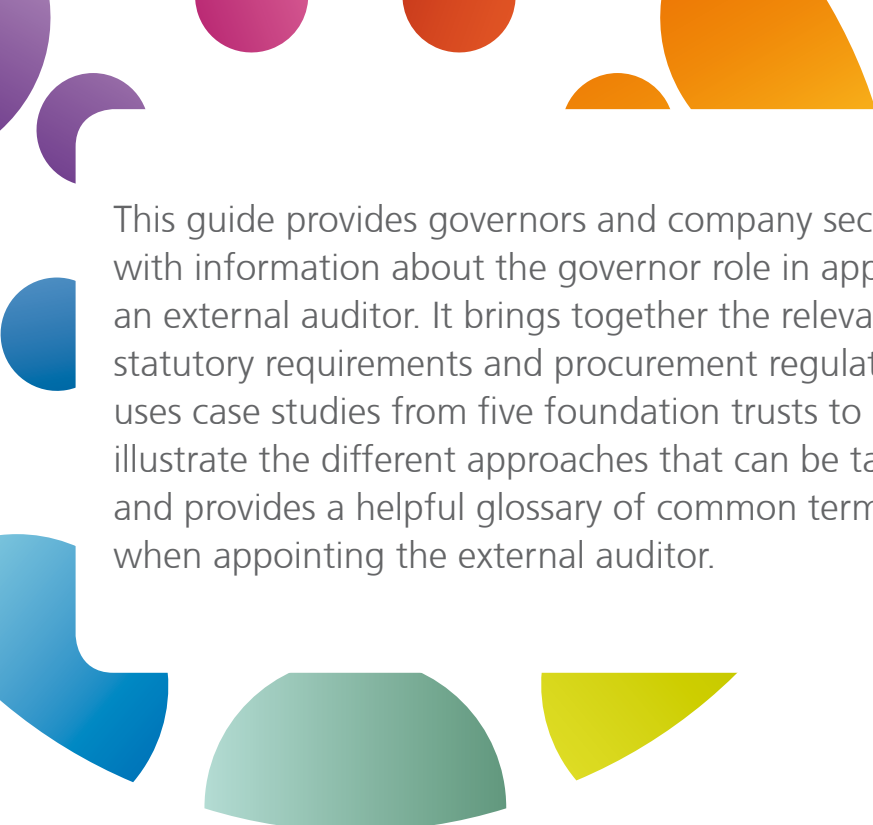


GovernWell

A one stop training resource for foundation trust governors

Appointing the external auditor: a guide for governors





This guide provides governors and company secretaries with information about the governor role in appointing an external auditor. It brings together the relevant statutory requirements and procurement regulations, uses case studies from five foundation trusts to illustrate the different approaches that can be taken and provides a helpful glossary of common terms used when appointing the external auditor.

CONTENTS

Background	1
Glossary and acronyms	2
Why is the appointment of the external auditor important for governors?	4
When do governors appoint an external auditor?	6
What are the rules and procedures governors need to be aware of?	8
What do governors need to know about external auditors?	10
What are the key stages of the appointment process and what should governors expect?	12
Process for appointment	17
NHS foundation trust case studies – appointing the external auditor	18
Case studies	20

BACKGROUND

An external audit is an examination of the annual financial statements of the foundation trust in accordance with specific rules by someone who is independent of the foundation trust. The external auditor performs the audit by examining and testing the information prepared by the foundation trust to support the figures and information it includes in its financial statements. In contrast, an internal audit provides the foundation trust with independent assurance that internal financial (and non-financial) processes and systems are working properly.

Foundation trusts will have contracts in place for the delivery of both external and internal audit. Both external and internal auditors report their work to the foundation trust's audit committee which is made up of nominated non-executive directors and is attended by the finance director. The audit committee is a committee of the board and therefore governors cannot be members. The audit committee uses the work of auditors to provide the board of directors with an independent and objective review of how the foundation trust manages its finances (financial governance), how it is structured to deliver its strategy (corporate governance) and how it manages its risks.

The audit committee is responsible for evaluating the performance of the foundation trust's external and internal auditors each year. It supports the council of governors to determine and deliver the process for appointing the external auditor every three to five years (depending on the length of contract used by the foundation trust). It is the council of governors who must meet and make the final decision on the appointment of the external auditor.

The external auditor addresses all its work to the council of governors. While there is no formal requirement for the external auditor to meet with or engage with governors typically external auditors present a report on their work to the council of governors often at the annual general meeting.

We would like to thank Suresh Patel at Mazars for putting this guidance together, and the five trusts which participated in providing case study information.

GLOSSARY AND ACRONYMS

Accountable

Foundation trusts are responsible to its membership and wider public for delivering its services in line with its licence from Monitor.

Audit Code for NHS foundation trusts (Audit Code)

Sets out the responsibilities of the external auditor as included in the NHS 2006 Act in relating to the external audit of a foundation trust.

External audit

Examination of a foundation trust's annual financial statements by someone independent of the foundation trust.

Financial statements

The foundation trust's annual accounts showing for a period of 12 months how much money it spent (and on what) and received (and from whom) and what it owns (including land, buildings and equipment) and what it owes to others.

Internal audit

Independent assurance on a foundation trust's internal financial (and some non-financial) processes and systems.

International Standards on Auditing (ISAs)

Common set of professional standards that all auditors must follow in delivering external audit to foundation trusts.

Invitation to tender (ITT)

The document that the foundation trusts issue to interested suppliers, outlining the foundation trust's detailed requirements for the external audit service.

Office of the Journal for the European Union (OJEU)

A daily publication advertising tender notices of the EU member states including invitations to tender and contract award notices.

Pre-qualification questions (PQQ)

A set of questions used by the foundation trust to establish minimum criteria that interested suppliers need to meet to progress to the next stage of the contracting process.

Procurement

The process by which foundation trusts buy goods and services.

Public Contracts Regulations

A legal framework that helps ensure that the process that public bodies follow to buy goods and services is conducted fairly and openly.

Standing Financial Instructions (SFIs)

Detail the financial responsibilities, policies and procedures adopted by the foundation trust.

Standing orders (SOs)

Internal rules that regulate the proceedings and business of the foundation trust and form part of its corporate governance arrangements.

Standstill period

A compulsory waiting period (10-15 days) between the decision to award a contract and the date on which the contract is signed in order to give unsuccessful bidders a chance to seek remedies if they were dissatisfied with the procurement process.

Statutory

Foundation trusts must adhere to requirements as laid out in the law, including the need to have an external auditor appointment at all times.

WHY IS THE APPOINTMENT OF THE EXTERNAL AUDITOR IMPORTANT FOR GOVERNORS?

The council of governors appoints the external auditor.

NHS foundation trusts are independent from central government and have greater control over decisions on the services they deliver. However they remain part of the NHS and are accountable to their members and the public through the council of governors. The external auditor plays an important role in this accountability structure, reporting to governors their independent opinion on the foundation trust's accounts and quality report. This is why the council of governors has the responsibility for appointment.

Typically, a small group representing the council of governors works with members of the audit committee to undertake the appointment process, but the final decision must be made by the council of governors.



WHEN DO GOVERNORS APPOINT AN EXTERNAL AUDITOR?

Foundation trusts must have an external auditor in place at all times. This is a legal requirement under the 2006 NHS Act. There are four instances that will trigger the need for the appointment. In all four instances, trusts and governors need to be aware of timescales to ensure that they meet the requirement to have an external auditor in place at all times.

Depending on the procedure the foundation trust follows the appointment process can take between three and six months. In practice the audit committee of the foundation trust will be aware of the triggers and engage with governors appropriately.



Photographs courtesy of Will Stedman Photography

Table 1: Triggers for the external audit appointment

Trigger for external audit appointment	When and how should governors be notified
1. When Monitor authorises a new foundation trust. [see case study 2]	Shadow governors should be made aware of the need to appoint an external auditor by the trust board secretary (or equivalent).
2. When a FT's existing audit contract expires. [see case study 5]	The audit committee should inform the council of governors prior to the commencement of the final year of the contract.
3. If the audit committee recommends that the governors remove the existing auditor.	The audit committee will report annually on the performance of the auditor to the council of governors and can make recommendations for the removal of the auditor, where appropriate.
4. When the existing auditor resigns. [see case studies 1-4]	The audit committee or finance director should notify the council of governors immediately they become aware of the potential for the auditor to resign.

Monitor recommends that foundation trusts go through a competitive process for the appointment of the external auditor every 3-5 years. Typically this competitive process involves seeking quotes from interested audit firms on the quality of the work that they will perform and the price they will charge for delivering the services required by the foundation trust.

WHAT ARE THE RULES AND PROCEDURES GOVERNORS NEED TO BE AWARE OF?

Foundation trusts must follow the Public Contracts Regulations, a legal framework that helps ensure that public procurement (the process for buying goods and services) is conducted fairly and openly. The appointment of the external auditor involves the award of a contract for services between a foundation trust and an external audit provider, typically a firm of accountants. Foundation trusts follow internal rules and regulations known as Standing Orders (SOs) aimed at ensuring competition, transparency and consistency in all forms of procurement. SOs are often published on the foundation trust's website.

SOs will outline a foundation trust's approach to contracts of different values. Generally the higher the contract value the lengthier and more involved the process will be. Table 2 shows a typical contract, but you should check the rules set by your own trust.

Table 2: An example of the procurement required for a contract by value

Contract value	Procurement required
Less than £10,000	Written quote from nominated supplier
£10,000 – £50,000	Obtain at least two competitive quotes
More than £50,000	Advertise as a formal tendering process

The SOs will also include reference to European Union procurement rules which require foundation trusts to advertise in the Office of the Journal for the European Union (OJEU) where the estimated total contract value (over the duration of the contract) exceeds £173,934. Contracts for external audit services tend to exceed the OJEU threshold.

There are four procurement procedures for public sector tenders. These are outlined below.

Table 3: Procurement procedures explained

Type of procurement	Explanation
Open	This is where all interested suppliers are asked to return tenders by a set date. These are then evaluated and the contract is awarded
Restricted	This is a two-stage process. In the first stage, interested suppliers are asked to fill out a questionnaire and a short-list is drawn up. In the second stage, the shortlisted suppliers are invited to respond to an Invitation to Tender (ITT). The tenders are then evaluated and the contract awarded.
Competitive dialogue	This procedure is used for more complex procurements. After a selection process, the buyer negotiates with suppliers and invites chosen companies to put in a bid. Suppliers put in their tenders and the contract is awarded
Negotiated	In this procedure, the buyer enters into contract negotiations with one or more suppliers.

Typically, an external audit tender follows the restricted procedure to enable foundation trusts to remove ineligible suppliers from the evaluation stage of the process. The open and restricted procedures do not allow the foundation trust to negotiate with suppliers.

Foundation trusts can also use Framework Agreements for procuring external audit. These agreements involve a list of suppliers which have been pre-approved by the organisation who operates the Framework Agreement (typically a specialist service for buying professional services) as meeting a prescribed set of eligibility criteria (including those outlined in the *Monitor's Audit Code for NHS foundation trusts*).

WHAT DO GOVERNORS NEED TO KNOW ABOUT EXTERNAL AUDITORS?

The role of a foundation trust external auditor is outlined in Monitor's *Audit Code for NHS foundation trust (the Audit Code)*. Essentially the external auditor:

- gives the governors an independent opinion on the truth and fairness of the accounts;
- reports to governors if they have not been able to satisfy themselves that the foundation trust is using its resources economically, efficiently and effectively; and
- provides the governors with independent assurance on the foundation trust's annual quality report.

There is recognition that the external audit of a foundation trust is a specialist activity. As such, to be eligible for appointment a firm must:

1. be established in the United Kingdom and be approved by Monitor;
2. have an established and demonstrable standing within the healthcare sector and be able to show a high level of experience and expertise; and
3. have robust internal quality control procedures to monitor the compliance of the audit work with the *Audit Code* and the standards that govern external audit in the UK.

In practice there are a large number of firms which can meet criteria 1 and 3 but a smaller group who can also demonstrate that they meet criteria 2. The ability of a firm to demonstrate that they meet these criteria will often form part of the initial appointment process.

External auditors must undertake their work following a set of common standards known as International Standards on Auditing or ISAs. These standards include a requirement for the senior member of the team (referred to as the engagement partner or engagement lead) to limit the number of years that they spend auditing an individual foundation trust. Most firms adopt a policy of 5-7 years although ethical standards for auditors allow up to 10 years after which the firm is required to consider taking action to ensure it can continue to be objective and independent.



WHAT ARE THE KEY STAGES OF THE APPOINTMENT PROCESS AND WHAT SHOULD GOVERNORS EXPECT?

Key stage of appointment process	Governors should expect to...
Decide on the appointment process	<ol style="list-style-type: none"> Be briefed by the foundation trust, typically by a combination of the chair of the audit committee, finance director, trust board secretary and procurement staff on the: <ul style="list-style-type: none"> role of the external auditor; scope of the external audit; procurement rules and regulations; timetable required to ensure that there is always an external auditor in place; and procurement options which include: <ul style="list-style-type: none"> the foundation trust's internal procurement team (see case studies 2 and 5); use of an external procurement service (see case study 3); or use of a procurement framework containing external audit firms who have already been confirmed as meeting the eligibility criteria (see case study 4). Be asked by the foundation trust to nominate governors who have an interest in making the appointment. The code of governance enables the council of governors to delegate authority to the audit committee for undertaking the appointment process. However, the council of governors should take a lead in the process and typically will request the involvement of two governors to represent the council on an audit working group or panel. Other members of the working group typically include the chair of the audit committee, the finance director and procurement. However, the case studies illustrate that there is no mandated approach to the membership of the audit working group.

Key stage of appointment process	Governors should expect to...																
Determine what the governors consider to be important considerations in appointing the external auditor	<ol style="list-style-type: none"> Be made aware that the work of an external auditor is determined by auditing standards that firms must comply with and the scope is prescribed by the <i>Audit Code</i>. The governors on the working group should expect to consider other criteria that they consider to be important for an external auditor. <p>They should also expect to consider the relative weightings associated to each criterion to enable each returning tender to be evaluated on a consistent basis.</p> <p>This may be different for each trust, an example may be:</p> <table border="1"> <thead> <tr> <th>Criteria</th> <th>% Weighting</th> </tr> </thead> <tbody> <tr> <td>Experience of the audit team</td> <td>25</td> </tr> <tr> <td>Quality of service delivery</td> <td>15</td> </tr> <tr> <td>Quality of communications</td> <td>10</td> </tr> <tr> <td>Added value offered</td> <td>15</td> </tr> <tr> <td>Fee competitiveness</td> <td>20</td> </tr> <tr> <td>Quality of engagement with council of governors</td> <td>15</td> </tr> <tr> <td></td> <td>100%</td> </tr> </tbody> </table> The working group may be involved or consulted on the drafting of the invitation to tender document which includes the tender criteria and weightings. 	Criteria	% Weighting	Experience of the audit team	25	Quality of service delivery	15	Quality of communications	10	Added value offered	15	Fee competitiveness	20	Quality of engagement with council of governors	15		100%
Criteria	% Weighting																
Experience of the audit team	25																
Quality of service delivery	15																
Quality of communications	10																
Added value offered	15																
Fee competitiveness	20																
Quality of engagement with council of governors	15																
	100%																

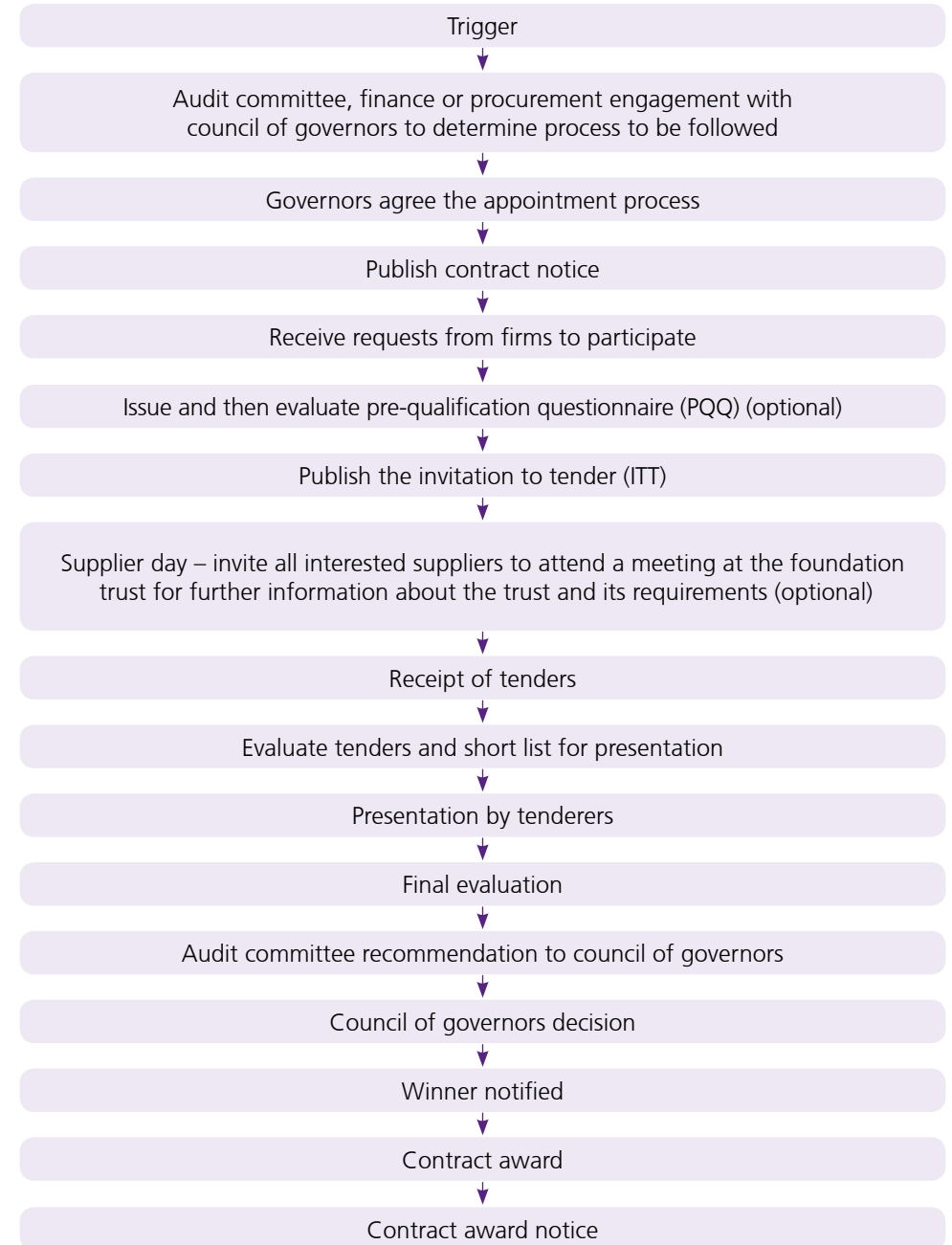
Key stage of appointment process	What governors should expect
Evaluate tenders received	<ol style="list-style-type: none"> 1. Procurement and/or finance staff should provide an evaluation sheet to enable governors to score each of the tenders against the agreed tender criteria. 2. Finance directors and audit committee chairs will support governors if required. 3. Foundation trusts have the option of using the tender evaluation to determine a short list of firms who are then invited to make a presentation to the evaluation panel. Alternatively the foundation trust may elect to invite all firms responding to the ITT to make a presentation.

Key stage of appointment process	What governors should expect
Final evaluation of tenders	<p>The working group should receive an analysis of their individually scored tenders and agree on a successful firm.</p> <p>A report will be drafted proposing the successful external auditor to the council of governors. It is the council of governors that makes the final decision.</p>

Key stage of appointment process	What governors should expect
Recommendation to the council of governors	<p>The council of governors should receive a report from the chair of the audit committee on the appointment process and the recommendation. The case studies show that the governors on the working group often jointly present the report to the council of governors.</p> <p>Once the council of governors makes the decision on the appointment of the external auditor, the rules relating to awarding contracts requires the foundation trust contact all of the firms involved in the process, including the successful firm, informing them of the decision and starting a ten day period (referred to as the standstill period) where unsuccessful firms can appeal against the decision. Following the ten days if no appeals have been received the foundation trust awards a contract to the successful firm.</p> <p>If the council of governors does not accept the recommendation the foundation trust must undertake the appointment process again, quickly, to ensure that the foundation trust has an external auditor in place at all times.</p> <p>There is no requirement for the foundation trust to publish details about the process it followed in appointing the external auditor. However, to promote transparency, foundation trusts can do so as part of reporting the work of the council of governors or the audit committee in its annual report.</p>



PROCESS FOR APPOINTMENT



NHS FOUNDATION TRUST CASE STUDIES – APPOINTING THE EXTERNAL AUDITOR

* The resignation of the external auditor is very rare. However, in 2010 the government announced the abolishment of the audit commission who at the time provided external audit services to almost fifty per cent of all foundation trusts. As a result, the audit commission was required to resign its foundation trust appointments thereby triggering the need for the affected foundation trusts to seek new external auditors.

	Foundation trust	Trigger	Process supported by	Timescale	Governor involvement	Specific support provided to governors
1	North East Ambulance NHS Foundation Trust	Resignation of auditor*	Framework agreement	5 months	Two governors on an audit task and finish group. Lead governor made the recommendation to the council.	Monthly programme of updates included a session from the incumbent auditors.
2	Royal Free London NHS Foundation Trust	Resignation of auditor* and gaining foundation trust status	In-house	3 months	Two governors on audit sub-group of council of governors. Audit committee chair presented the recommendation to council with the two governors.	Nothing specific.
3	East London NHS Foundation Trust	Resignation of auditor*	External procurement service	7 months	Two governors involved in the process. Chair of audit committee made the recommendation to the council.	Informal and 1-2-1 support from foundation trust managers.
4	The Walton Centre NHS Foundation Trust	Resignation of auditor*	Framework agreement	6 months	Three governors formed a working group. Lead governors made recommendation to the council.	Presentation to council of governors on the role of external audit and briefings from the finance director and head of procurement.
5	Birmingham and Solihull Mental Health NHS Foundation Trust	Expiry of existing contract	In-house	6 months	Four governors established a working group. Working group presented the recommendation to the council.	Several sources of guidance provided to governors including a number of face to face sessions over a two week period and a meeting with the chair of audit of another foundation trust initiating the same process.



Photographs courtesy of Will Stedman Photography

CASE STUDIES

For all five case studies the chair of the foundation trust audit committee made a recommendation to the council of governors on the firm to appoint as external auditor and in all case studies the council of governors accepted the recommendation.

Case studies 1-4

The resignation of the external auditor is very rare. However, in 2010 the government announced the abolishment of the audit commission who at the time provided external audit services to almost fifty per cent of all foundation trusts. As a result, the audit commission was required to resign its foundation trust appointments thereby triggering the need for the affected foundation trusts to seek new external auditors.



1. North East Ambulance NHS Foundation Trust (September 2012 appointment)

The foundation trust used an existing skills audit of their governors to enable the council of governors to quickly identify two governors to represent them on an audit task and finish group which managed the process. The audit task and finish group reported to the audit committee and its membership also included the audit committee chair, another NED, the finance director and head of procurement. The council of governors' monthly programme included a session on the role and duties of the external auditor.

The audit task and finish group considered the different procurement options available to the foundation trust and due to the time constraints it faced, agreed to use a framework agreement for external audit. This meant that the foundation trust had access to a list of audit firms which had already met the eligibility requirements outlined in the *Audit Code*.

The foundation trust still required interested firms to make a presentation to support their tender response.





Royal Free London **NHS**
NHS Foundation Trust

2. Royal Free London NHS Foundation Trust (September 2012 appointment)

The Royal Free London achieved foundation trust status on 1 April 2012 and owing to the inability of the incumbent to continue as external auditor the foundation trust was required to start the appointment process. The council of governors identified one governor with relevant experience and another governor volunteered to form a task and finish sub-group. The sub-group also included the chair of the audit committee, another NED, the finance director and deputy director of finance. The process which comprised a pre-qualification questionnaire, evaluation of responses to the ITT and a presentation from shortlisted firms was largely led by the finance director and deputy director of finance with regular engagement with the council of governors.

The governors represented on the task and finish sub-group were not directly involved in the pre-qualification evaluation but did evaluate the tenders and were part of the panel that received the presentations from invited firms. The governors were unable to use the accepted commercial practice of requesting 'best and final offers' after firms had submitted their proposals because of the restricted procedure used by the foundation trust.



East London **NHS**
NHS Foundation Trust

3. East London NHS Foundation Trust (April 2012 appointment)

The foundation trust was undertaking its second external audit appointment process in 2012. The audit committee chair and director of finance presented a report to the council of governors on their involvement in the process to appoint a new provider. The council of governors identified two governors to join a group to lead the process, which also included the chair of the audit committee, the deputy director of finance, the head of procurement and the director of governance. The two governors received informal and one-to-one support from foundation trust staff to help them to understand the role of external audit.

The foundation trust decided to use an external procurement service to facilitate the management of the tender process. Although the governors on the group had limited involvement in the pre-qualification questionnaire they did bring a focus on the quality agenda in the discussions on the tender specification. The governors were part of the evaluation panel receiving tenders and presentations from invited firms and again focused their questions on the quality agenda.

4. The Walton Centre NHS Foundation Trust (September 2012 appointment)

The foundation trust was required to start the appointment process following the inability of the incumbent to continue as external auditor. The director of corporate and research governance talked to the council of governors and outlined the role of external audit, the appointment process and the council agreed that the process be kept as simple as possible.

Three governors volunteered to join a working group to lead the process, including one governor with a financial background.

The working group was supported by briefings and information from the chair of the audit committee, the director of finance and procurement. The foundation trust used an existing procurement framework used by other public bodies for external audit so the working group had no involvement in the pre-qualification stage of the process.

The governors also requested that the foundation trust staff set the tender specification and evaluation criteria however the three governors did form the evaluation panel along with the chair of the audit committee. The director of finance and the director of corporate and research governance advised the panel but did not evaluate the tenders.

The governors felt that their involvement helped ensure the appointment of an external auditor who understood the foundation trust and had the requisite skills and experience to deliver a quality service.

5. Birmingham and Solihull Mental Health NHS Foundation Trust (November 2013 appointment)

The foundation trust began undertaking its second external audit appointment process in June 2013 as the existing three year contract was extended one year to include the financial year 2013/14. As such it had more time to plan and prepare for the role of the council of governors in the appointment process. It also had learning from the first appointment process. As a result the foundation trust invested significant time and resource into ensuring governors were supported and made sufficiently aware of the role and duties of the external auditor to enable them to discharge their responsibilities in making the appointment. The council of governors formed a working group comprising four governors with a variety of experience but none directly related to external audit.

The group received training and guidance throughout the process including access to guidance documents such as the HFMA audit committee handbook, discussions with the chair of the audit committee and presentations from the foundation trust's internal auditors on the role of external audit and from the chair of audit committee from another foundation trust going through the same process. The governors were instrumental in drafting the invitation to tender document including challenging the weightings and scoring of the evaluation criteria. The working group also decided on an evaluation panel which comprised the working group, the chair of the audit committee and the chief financial officer.

The governors focused on the non-technical aspects of the external audit function, particularly around the importance of effective working relationships between the auditor, foundation trust staff and the council of governors.



GovernWell

A one stop training resource for foundation trust governors

GovernWell is the national training programme for foundation trust governors run by the Foundation Trust Network. The programme aims to be a one-stop resource for governors to develop their knowledge and skills.

To find out more visit:

www.foundationtrustnetwork.org/governwell



Produced in partnership with Mazars – an international audit, accounting and advisory firm, working with foundation trusts and other UK public bodies.

© GovernWell 2014. This text is copyright and may not be reproduced without permission.