

# Consultation on scale of audit fees for 2020/21

**Opted-in local government and police bodies**

**January 2020**

**Public Sector Audit Appointments Limited (PSAA) is an independent company limited by guarantee incorporated by the Local Government Association in August 2014.**

**In July 2016, the Secretary of State specified PSAA as an appointing person for principal local government authorities for audits from 2018/19, under the provisions of the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2015.**

**From 2018/19 PSAA is responsible for appointing an auditor and setting scales of fees for relevant principal authorities that have chosen to opt into its national scheme.**

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# Consultation on 2020/21 scale of fees

## Introduction

1. This consultation considers the proposed scale of fees for the work to be undertaken by appointed auditors in respect of the 2020/21 financial statements for local bodies that have opted into Public Sector Audit Appointments' (PSAA) national auditor appointment scheme.
2. PSAA is specified by the Secretary of State for Housing, Communities and Local Government under the Local Audit and Accountability Act 2014 (the Act 2014) and the Local Audit (Appointing Person) Regulations 2015 (Regulations) as the appointing person for principal local government bodies in England, including local police and fire bodies. Under the Regulations we are responsible for consulting on and setting scales of fees for authorities that have opted into our auditor appointment scheme.
3. Scale fees are based on the expected audit work to be undertaken by appointed auditors under the requirements of the:
  - Code of Audit Practice (Code) and supporting Auditor Guidance Notes (AGNs) published by the National Audit Office (NAO);
  - financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC; and
  - professional standards applicable to auditors' work.
4. Other factors that may also need to be taken into consideration in setting the fee scale include changes in audit regulation and inflation. We also take account of the previous year's audits to identify and consider the ongoing implications of any relevant factors that may have emerged.
5. The Regulations require PSAA to set a fee scale before the beginning of the relevant financial year, and that this cannot be amended after the financial year has begun. However, the Regulations allow the audit fee for an individual body to be varied if substantially more or less audit work is required than envisaged by the scale of fees. In some cases this may result in a one-off fee variation affecting a single year, in others it may point to the need for a permanent adjustment to the scale fee for the body concerned.
6. The timing of this year's consultation is slightly later than usual. Under normal circumstances we would have consulted on our approach to the scale of fees for 2020/21 during October 2019 to December 2019. However, we wrote to all S151 officers explaining the need to delay the consultation pending finalisation of the new NAO Code of Audit Practice. The consultation on the Code has now been completed and the new Code was formally laid in Parliament on 22 January 2020. The AGNs that support the Code will provide more detail on the auditor's responsibilities, and we understand that the NAO intends to consult publicly in Summer/Autumn 2020 on them.
7. The background to the 2020/21 fee consultation is unusually turbulent and challenging. Following a number of significant corporate financial failures in the private sector, the Government has commissioned three important reviews. Sir John Kingman has reviewed

audit regulation, the Competition and Markets Authority has reviewed the audit market, and Sir Donald Brydon has reported on the quality and effectiveness of audit. In addition to these reviews which focus primarily on private sector audit, Sir Tony Redmond is currently reviewing financial reporting and audit in local government and is expected to report later this year.

8. It is not yet clear what the long term implications of these reviews will be. However, the impact of early recommendations has been significant, heightening the pressure on auditors to meet regulatory requirements to deliver audits which reflect greater professional scepticism across all sectors, including local audit.
9. The outworking of these pressures has had a major impact on the conduct of local audits of 2018/19 financial statements, and has highlighted a number of significant underlying challenges for local auditors and/or audited bodies. These include the very tight timetables for preparation of accounts and delivery of audit opinions; recruitment and retention difficulties which are resulting in an increasing shortage of audit resources with suitable experience for local government work; auditor concerns about the quality of some bodies' pre-audit accounts and working papers; and challenges resolving technical issues within increasingly complex accounts. The end result has been a significant number of audit opinions being delayed beyond the 31 July target publication date set out in the Accounts and Audit Regulations.

## Responding to this consultation

We welcome comments on the proposals contained in this document. Please send comments by email to:

[workandfeesconsultation@psaa.co.uk](mailto:workandfeesconsultation@psaa.co.uk)

The consultation will close on **Friday 6 March 2020**.

## Proposed fee scale for 2020/21

10. Setting the fee scale for audits of 2020/21 financial statements is challenging. It requires consideration and assessment of the impact of a range of factors, many of which are difficult to quantify at this stage. They include:
  - issues which have given rise to additional audit work in relation to 2018/19 accounts, or are expected to arise and have implications for 2019/20 accounts' audits, and which may or may not have ongoing implications for subsequent years;
  - new auditing standards and regulatory requirements, including any decisions taken by Government in response to the reviews highlighted in para 7; and
  - the introduction of the new Code of Audit Practice and related AGNs, the implementation of which may have one-off and/or ongoing implications for the extent of auditors' work.
11. Paras 19 to 32 below provide further and more detailed information about some of the potential factors concerned. The list is illustrative rather than comprehensive.
12. The nature of many of the factors highlighted is that their impact is likely to vary from one audited body to another. Even within classes of similar bodies impacts may vary significantly depending upon local characteristics which have implications for audit risks. Importantly, although the new Code and the revised AGNs will clearly apply to all bodies, they may require different levels of audit work depending, for example, on the maturity of the body's value for money arrangements in respect of the specific themes/reporting criteria identified in relation to the new audit commentary, namely financial sustainability, governance and improving economy, efficiency and effectiveness.
13. In PSAA's view, discussions about the impact of the factors outlined needs to take place at local body level between the appointed auditor and an authorised representative of the audited body, such as the chief finance officer. This is the level at which each factor or variable can be considered in the distinctive context of the particular body, having regard to any implications for audit risk and the extent of any additional audit work which may be required to enable an appropriate level of assurance.
14. Our expectation is that such discussions should take place as soon as possible as part of planning discussions for 2019/20 audits and with a specific aim also to look ahead to identify any implications for 2020/21. Where a factor is relevant to the specific body concerned the parties should consider whether any additional audit work is likely to be required and, if it is, whether it is likely to be a one-off response, i.e. in all probability affecting a single audit year, or an ongoing requirement. The former will potentially translate to a one-off fee variation; the latter will logically lead to an ongoing scale fee adjustment.
15. In some cases it may not be possible to quantify the implications for audit work at this stage or perhaps even until the work is done. Nevertheless early discussions will help to align expectations and mitigate the risk of audited bodies being unaware of the prospect of charges for additional work until very late in the audit process - a cause of understandable frustration when it arises.

16. PSAA will consider the reasonableness of any proposed one-off fee variations and/or ongoing adjustments to scale fees arising from these discussions. Ideally the majority of such conclusions will reflect an agreed position which is supported by both the audited body and the auditor. However, even where agreement has been reached, PSAA will review proposals and advise the relevant parties if we have any significant concerns. In the event that authorised representatives and auditors are unable to reach an agreed position, PSAA will arrange a discussion with the parties with a view to determining a fair outcome in relation to any one-off variations or ongoing scale fee adjustments arising.
17. We believe that local discussions of the type outlined will enable an important exchange of views and information between auditor and audited body. As well as addressing the factors listed in this consultation document, it will provide an opportunity for both parties to raise any other issues which they consider to be relevant to the efficient conduct of the 2020/21 audit. The outcomes of the discussion will inform planning and preparation for the audit, and should be reflected in the audit plan submitted to the body's audit committee or other responsible group, ensuring that those charged with governance are appropriately informed.
18. PSAA does not need to increase scale fees for any other pressures affecting the company's own costs including inflation. Accordingly, we propose that the base scale of fees for 2020/21 should remain unchanged from the scale agreed in respect of 2019/20 audits. However, as outlined above, we envisage that local discussions between audited bodies and auditors will lead in some cases to ongoing adjustments to individual scale fees as well as to one-off variations. For transparency, we will summarise the volume and extent of these adjustments and variations as part of our established quarterly audit contract monitoring reporting arrangements ([Quarterly Monitoring Report](#)).

### **Auditors' assessment of risk and complexity – key variables**

19. The paragraphs below provide a summary of some of the variables which may have implications for audit risk and work and which may therefore need to be considered in local discussions between auditors and audited body representatives.

#### Code of Audit Practice and supporting guidance notes

20. Under the provisions of the 2014 Act, the NAO is responsible for publishing the statutory [Code of Audit Practice](#). It also publishes supporting AGNs for auditors. The 2014 Act requires the Code be reviewed and revisions considered by Parliament at least every five years. The current Code came into force on 1 April 2015, and the new Code will apply from 1 April 2020, i.e. from audits of 2020/21 accounts.
21. The current Code requires the auditor to give an opinion on the financial statements of a body subject to audit under the 2014 Act, and a conclusion on the arrangements for value for money (VFM). The new Code requires a sharper focus on VFM arrangements, with specific reporting criteria on: financial sustainability, governance, and improving economy, efficiency and effectiveness. The new Code also requires auditors to provide a commentary on their findings, rather than the current requirement to state a conclusion on whether the audited body did or did not have appropriate arrangements in place.
22. The proposed Code states that determining how much work to do on arrangements to secure VFM is a matter of auditor judgement, based on the requirements set out in the

Code and supporting guidance. Supporting AGNs will be published later in 2020 as referenced earlier in this paper.

23. The extent of any additional work to be required on VFM arrangements will depend on local circumstances and may vary from year to year and from authority to authority. Further, there may be a one-off effect as both authorities and auditors make the transition from old to new requirements and lay the foundations for appropriate audit coverage.
24. Early discussions about the new Code will be helpful. However, definite conclusions about implications for audit risk and workplans will need to await and have regard to relevant guidance (AGNs). PSAA will also be able to consider the impact of the new Code requirements in more depth once the AGNs are finalised. At that stage we may be able to provide indicative ranges in relation to the likely fee implications for different types and classes of body.

#### Financial reporting requirements

25. The scale fees reflect the audit work needed at audited bodies based on current financial reporting requirements. Any changes to these requirements may have an implication for the extent of audit work required to deliver an appropriate level of assurance.
26. For example, from 2020/21 the Code of Practice on Local Authority Accounting issued by CIPFA/LASSAC requires the adoption of the requirements of an updated version of IFRS16 on the treatment of leases. The changes to the requirements may mean additional work is needed.
27. The impact of the standard will vary between authorities and accounting periods, based on factors such as the volume of leases and quality of documentation. There may be a greater impact in the first year of implementation of the new standard compared to subsequent years.
28. Auditors will need to have local discussions with individual opted-in bodies about IFRS16 as the bodies will need to disclose the estimated impact in their 2019/20 accounts. These discussions will inform the auditor's judgement about the amount of additional audit work that will be needed for both 2019/20 and 2020/21. Bodies may wish to discuss with auditors if there are any actions which they can take to reduce the extent of additional audit work needed.

#### Professional standards applicable to auditors' work

29. Auditors are under increasing pressure to demonstrate greater professional scepticism when carrying out their work, for example, by exercising greater challenge in areas where management makes judgements or relies on advisers/experts. The International Auditing and Assurance Standards Board (IAASB) has revised its standard on accounting estimates, 'ISA 540 (Revised) – Auditing Accounting Estimates and Related Disclosures', to respond to the evolving business environment. The revision is intended to ensure that the standard continues to keep pace with the changing market and fosters a more independent and challenging/sceptical mind-set in auditors. Audit firms in turn have updated their work programmes and reinforced their internal processes to meet the new expectations.



30. ISA 540 (Revised) becomes effective for financial statement audits for periods beginning on or after 15 December 2019 and will therefore apply for 2020/21 audits. The current version of the standard has 23 required procedures for auditors to apply to test each significant estimate in the accounts; the revised standard has 39. These changes are likely to have a variable impact on 2020/21 audit plans depending on the type, number and significance of estimates included in an individual authority's financial statements.
31. More generally, regulatory standards are being raised and seem set to continue to do so in response to widely reported financial failures in the private sector and resulting reviews commissioned by Government. Current regulatory practice is to apply standards to all relevant audits, unless specifically dis-applied or adapted (for example by Practice Note 10).

#### Quality of financial statements and supporting working papers

32. Scale fees are based on the expectation that bodies will provide the auditor with complete and materially accurate financial statements with supporting working papers. Where this is not the case, the auditor may need to undertake further work. Local discussions provide a useful opportunity to anticipate and highlight any issues which may give rise to incomplete or inaccurate accounts and/or supporting papers.

#### **The proposed fee scale for 2020/21**

33. We propose a fee scale for 2020/21 which is unchanged from the fee scale for 2019/20. As outlined above, we have not attempted to make allowance for matters such as those set out in paragraphs 19-32, because their impact will vary from one body to another and therefore requires local discussions between auditors and individual bodies.
34. If an auditor wishes to put forward a proposed adjustment to the scale fee in response to any of the matters set out in paragraphs 19-32 above, or other matters, we will, if time permits, take that into account in finally setting the scale fee before 31 March 2020. Otherwise such proposals will be considered in the usual way as part of the fee variation process.

#### **Fee consultation 2019/20**

35. We invited responses to the consultation on the 2019/20 fee scale from over 480 opted-in bodies and other institutions and received a total of 30 responses. They were generally positive about the proposal not to change the level of scale fees.
36. However, audit providers raised some concerns about the:
  - difficulties created by some very low scale fees, particularly for pension fund audits. Irrespective of size and complexity there are core audit requirements that auditors have to meet to complete an audit which is compliant with the requirements of the Code and professional standards, including the same suite of auditor reports and attendance at similar numbers of meetings with those charged with governance;
  - low hourly rates for charging additional fees – the standard hourly rates provided by PSAA for charging for additional Code related work have been adjusted in line with fee reductions over the years. Several firms challenged the logic of reducing rates in this way, explaining that fee variations increasingly relate to new, higher risk areas

and require expertise from elsewhere in the firm, at rates which routinely exceed audit rates; and

- additional audit work required for a Public Interest Entity (PIE), as this status requires an enhanced audit report. Given its ongoing nature, auditors suggest that these additional requirements should be reflected in adjustments to relevant scale fees rather than via a succession of one-off variations.
37. We accepted that if an audited body becomes a PIE, there is ongoing additional work needed and that a new scale fee should therefore be established. We are also currently exploring a range of issues in relation to scale fees in more detail, and have established a project which will conclude in 2020. The PSAA Board will consider the outcome of this research to determine any improvements that should be made to the processes for setting and varying scale fees including the methodology for making adjustments to any relevant individual scale fees.

### **Fee variations process**

38. Variation requests must be made to PSAA by the auditor using a standard process. The auditor cannot invoice an audited body until PSAA has approved the request.
39. Fees for considering objections will be charged from the point at which auditors accept an objection as valid. Similar arrangements will apply to any special investigations undertaken, such as those arising from disclosures under the Public Interest Disclosure Act 1998.

### **Value added tax**

40. All the 2020/21 fee scales exclude value added tax (VAT), which will be charged at the prevailing rate of 20 per cent on all work done.

## Next steps

41. PSAA has a statutory duty to prescribe a scale of fees for the audit of accounts of bodies that have opted into its national auditor appointment arrangements. Before prescribing scale fees, we are required to consult opted-in authorities, representative associations of relevant authorities and bodies of accountants.
42. We welcome comments from audited bodies and stakeholders on the proposals outlined in this document. The consultation will close on **Friday 6 March**.

Please send comments or questions by email to:

[workandfeesconsultation@psaa.co.uk](mailto:workandfeesconsultation@psaa.co.uk)

43. Following responses to this consultation, we will publish the final 2020/21 scale of fees for publication in March 2020.
44. If you have complaints about the way this consultation has been conducted, these should be sent by email to [generalenquiries@psaa.co.uk](mailto:generalenquiries@psaa.co.uk).