

Summary of the response to PSAA's consultation on a proposed new system for fee variations (subject to clearance with MHCLG)

1 Executive summary

PSAA has consulted on changes to fee variations arrangements, to introduce a new approach for national variations where changes in audit requirements relate to the conduct of all or most audits and where a standard cost can reasonably be estimated across groupings of bodies. The consultation also set out a proposed increase in the fee rates for additional work.

On the basis of the positive response to the consultation, PSAA has resolved to implement the proposed changes:

- a programme of research is under way to consider the likely impact on audit work and fees of some expected changes in audit requirements. We will consult opted-in bodies and other stakeholders on proposals where we identify changes for which a national approach would be appropriate;
- the new approach to national variations will apply for the first time in relation to audits of 2020/21 financial statements and value for money arrangements; and
- all variations - both national and local - arising in relation to audits of 2020/21 financial statements and value for money arrangements will be calculated in accordance with a new rate card reflecting increased hourly rates for different categories of audit staff.

2 Introduction

In November 2020 PSAA consulted opted-in bodies, audit firms, and other stakeholders on changes to current fee variations arrangements. The consultation set out proposals for PSAA to take a national lead on additional fees for new audit requirements, where these clearly apply to all or most audited bodies. In consulting on these proposals, PSAA was responding to concerns raised by many contributors about the impact of increasing numbers of fee variations for additional audit requirements.

The consultation took place in the context of the significant current tensions and pressures in the audit market, and of a series of recent reviews commissioned by government (the Kingman review of audit regulation, the Competition and Markets Authority review of the audit market, the Brydon review of the quality and effectiveness of audit, and the Redmond review of local audit and financial reporting). MHCLG published the Government's initial policy response to the Redmond review in December 2020, after our consultation, and has committed to providing more details on reshaping local audit in Spring 2021.

3 PSAA's role in local audit

In the local audit framework PSAA's responsibilities as the appointing person are specifically to appoint auditors to opted-in bodies, set scales of fees, and manage contracts with audit firms for delivery of external audit services to opted-in bodies.

The National Audit Office sets the scope of auditors' work in the Code of Audit Practice, published on a five-yearly cycle. The Financial Reporting Council determines regulatory requirements, often as a result of its annual audit quality reviews once an audit year is completed. CIPFA/LASAAC prescribes the financial reporting requirements applicable to local government bodies. All these requirements shape the work auditors undertake and have a bearing on the actual fees required.

4 The rationale for changes to fee variations arrangements

Auditors and auditing have been subject to very high levels of scrutiny in recent times following a number of widely reported financial failures in the private sector. As a result, auditors have needed to extend their work programmes to satisfy higher regulatory expectations. The scope of local audit work has also evolved, with a new Code of Audit Practice in 2020 and other changes in technical and professional requirements. These changes have led to the need for additional audit work and fees at the majority of opted-in bodies.

Under current local audit framework regulations, PSAA must set a fee scale before each financial and subsequent audit cycle begins. At that stage the audits of the previous financial year have not been undertaken, so PSAA does not have the benefit of accurate information on any additional costs for the next fee scale. The regulations do not allow for changes to the fee scale after the start of the financial year but allow for fee variations if the need for additional audit work arises. This presents very real challenges in setting accurate fee scales, which in turn has created pressure on the fee variations process because of the higher number of claims than previously.

In its [initial response to the Redmond report](#) MHCLG has said “Subject to consultation, the Department will review and reform regulations to provide the appointing person with greater flexibility to ensure the costs to audit firms of additional work are met. This could include enabling the appointing person to allow a fee scale to be set or changed in-year (subject to consultation with the auditor and the audited body), and/or enabling the appointing person (subject to appropriate consultation) to set additional fees across groupings of audited bodies in-year where there is clear evidence of additional work that affects those groupings.” In PSAA’s view the changes outlined would be extremely helpful and a welcome step towards a more flexible system.

The current fee variations process requires the auditor to discuss all proposed variations with audited bodies before submission to PSAA for determination. Feedback from both auditors and audited bodies frequently refers to the pressures this requirement places on them. They are also concerned about the practical challenges and limited value of local discussions about proposed variations which relate to factors which affect most or all audited bodies.

5 The proposed changes on which PSAA consulted

Our consultation set out proposals for a new approach to fee variations for audits of 2020/21 and subsequent accounts, based on two types of variation:

- **national variations**, for changes that relate to the conduct of all or most audits, such as changes to the auditing and accounting codes, standards and regulatory requirements, where a standard cost can reasonably be estimated; and
- **local variations**, for issues that relate to local factors arising from the conduct of a particular audit, such as the additional audit work required if accounts reflect complex transactions that are not built into the scale fee, or where working papers are poorly prepared, or for work relating to an auditor’s statutory responsibilities such as objections, statutory recommendations or public interest reports.

We believe national variations can obviate the need for local fee variation discussions for system-wide issues, relieving audited bodies and audit firms of much of the burden of dealing with them at local level. The proposed approach responds directly to stakeholders’ expressed concerns and offers the prospect of improving both the efficiency of the fee variation process and the consistency of resulting outcomes.

The circumstances in which PSAA would be able to determine a national fee variation, or set out a fee range, will depend on the applicability of the particular change in requirements to all opted-in bodies or groupings of bodies. It will also depend on the extent to which the additional work required is predictable and consistent across bodies rather than variable based on local conditions. As an example, the

McCloud pensions judgement has been a national issue in recent years, but the additional work required would not lend itself to a national fee variation because application varies significantly between audited bodies and in an unpredictable way.

The consultation also proposed an increase of 25% in the fee rates used for fee variations. The rates have been subject to successive fee reductions in recent years, linked to changes in scale fees. Over the same period, rates for audit work in other sectors have risen. This is an increasing concern to audit suppliers given the higher volumes and complexity of some of the additional work for which fee variations are needed. The proposed new rates continue to be keenly competitive compared to rates payable in other sectors.

6 Consultation results

We received a very encouraging response to the consultation, with 90 replies in total (almost double the number of replies to our most recent fees-related consultation, on the 2020/21 fee scale, in January 2020).

Opted-in bodies accounted for 80 (89%) of the replies, with the remaining 10 replies from representative organisations of local government and police bodies (6%), audit firms (4%), and one response from a member of the public. Responses from opted-in bodies covered most opted-in body types, including councils, police, fire bodies, and other local government bodies. Responses from councils were from district councils, county councils, metropolitan districts and London boroughs.

The consultation asked for feedback on five questions, as well as providing the opportunity to make general comments. The five questions and the proportion of positive responses in each case were:

Question	% Yes
1. Do you agree that fee variation arrangements should be changed to improve the efficiency of the process and to help manage the pressures on senior finance staff and auditors?	94%
2. Do you agree that a system based on two distinct categories - national variations and local variations - would be a logical approach?	94%
3. Do you agree that PSAA should lead on national variations, carrying out research to enable it to assess appropriate additional fees for groups of bodies with similar characteristics, with appropriate consultation?	94%
4. Do you agree that local discussions between the auditor and the audited body should continue to be a requirement in relation to additional audit work arising from factors which are specific to a particular audited body?	100%
5. Do you agree that the fee rates applicable to fee variations should be increased in recognition of the importance of maintaining a sustainable local audit market?	64%

7 Key themes identified in consultation responses

Many consultation responses provided detailed additional comments for each question and on the consultation in more general terms. While there is clearly overall support for PSAA's proposals, the comments suggest that stakeholders may have different views and concerns about aspects of the detail.

Opted-in bodies

In general terms opted-in bodies are supportive of the proposals to introduce national fee variations arrangements. They would like to see the approach applied to as wide a range of topics as possible and would like more information on how the arrangements will work in practice. There is a contrary view from a small number of bodies that national fee variations are not needed, and that local discussion about additional audit requirements works well for them.

Some consultation responses highlight an expectation that national variations will need to take account of the local circumstances of individual bodies, implying that local discussion about the applicability of any national changes will continue to be required.

All consultation responses confirm that local discussion about additional fees for local changes in audit risk should continue.

PSAA has commissioned a programme of research to assess the potential suitability for national determination of a series of forthcoming changes in audit requirements, such as the introduction of IFRS 16 on leases. Where it is possible to determine a national variation, that is a national fee that would be appropriate across all, or groupings of, relevant bodies, we will consult opted-in bodies and other stakeholders on our proposals. Where it is not possible to determine a national variation, we aim to provide information on appropriate fee ranges for groups of audited bodies and other factors that may need to be considered.

While there is overall support for an increase in the fee rates applicable to fee variations, there is a broad spectrum of views about the need for the increase. Some responses recognise that rates must be consistent with the work auditors need to undertake to discharge their responsibilities, and that securing the sustainability of the local audit market is very important in the longer term. Others are less supportive, questioning the basis of the proposal and reflecting on the challenging financial circumstances for local government bodies and the delays experienced in recent years in finalising audits.

Audit firms

Audit firms are also generally supportive of the consultation proposals, seeing them as logical and welcoming the aim of improving efficiency in the process of determining additional fees for additional work. They highlight their concerns about the time and effort currently involved in local discussions about additional fees and the time it takes for PSAA to challenge and, ultimately, determine local fee variation requests. Two firms suggest that where opted-in bodies and firms agree on additional fees, it should not be necessary to seek PSAA approval.

While they support the proposed increase in the fee rates for variations, the firms are unanimous that the proposed increase is not sufficient to address their concerns. Firms pointed out that additional work often relates to more complex or higher risk areas and can require input from specialists, which has an impact on fees.

Other stakeholders

The main group in this category of responses is the representative organisations for local government bodies. These consultation responses provide opposing views, from those which are supportive of PSAA's proposals to those that are not. Responses on behalf of organisations representing district councils do not support the proposed introduction of national fee variations arrangements or the increase in fee rates for variations.

Key themes

The key themes raised in responses to the consultation are summarised in the table below.

Consultation themes

Theme	Number* of organisations	%**
National fee variations		
Separating out the two types of fee variations as proposed is logical. It should help to streamline the process, and provide clarity, consistency and improved efficiency	26	29%
The fees for any national variations should take account of the local circumstances of individual bodies to ensure they are applied fairly	20	22%
The process for determining national fee variations should be clear and transparent, should apply to the broadest range of issues as is possible, and should be mapped out in more detail	17	19%
It is important to consult on any proposals before setting a fee for national variations	15	17%
National variations should be identified as early as possible to provide clarity on additional fees, and preferably sufficiently early to enable them to be reflected in the scale fee	8	9%
The current approach is not onerous, and could provide greater flexibility	3	3%
Local variations		
More guidance is needed to help bodies understand the process and to challenge local variations	14	16%
PSAA must have a role to adjudicate where there is no agreement between auditor and body	10	11%
There should be a more realistic timetable for the fee variations process	6	7%
Where an auditor and body have agreed a local fee variation, PSAA should accept the agreed fee	2	2%
Fee rate increase		
An increase in fee rates should be accompanied by improvements in audit quality, timeliness and resourcing	19	21%
A clearer justification is needed on the rationale for a 25% increase specifically and how it relates to any increase in costs	14	16%
Fees should not increase – existing contracts should already allow a contingency for any additional work or fees needed	11	12%
Fees are too low for the market to be sustainable	7	8%
The increase in fee rates is not sufficient to cover the additional work and does not allow for use of specialists	4	4%

Source: PSAA analysis

*Respondents generally commented on more than one theme

** % of total responses

We have set out more information on the questions raised in the consultation in the Q&As in the Appendix to this consultation summary.

8 Next steps

The PSAA Board has considered the outcome of the consultation on changes to the fee variations system and agreed to implement the proposals in the light of the largely positive response.

As set out in the consultation, we have commissioned a programme of research to consider the likely impact on audit work and fees of some expected changes in audit requirements. It is possible that some changes in audit requirements may not result in an increase in audit work, but others are potentially significant and may be suitable for national fee variations. We are engaging with the NAO and FRC to test our thinking and ensure that any resulting additional fees determined are reasonably consistent with any other relevant assessments. We will consult with opted-in bodies and other stakeholders, including suppliers, on proposals for specific national variations. If for any reason revised regulations enabling the handling of national variations as outlined are not approved, PSAA's default position would be to issue findings based on its research into relevant new standards and other relevant changes. This may include information on the likely range within which fee variations for associated additional audit work would be expected to fall (noting that there may be exceptions to that range due to local circumstances).

We will be working closely with MHCLG to ensure that implementation of the new arrangements is consistent with their work to reshape local audit in response to the recommendations of the Redmond review. We understand that they intend to publish more detail on their evaluation of options in Spring 2021.

Pending subsequent implementation of any changes to the local audit framework, PSAA will continue to discharge its statutory responsibilities, including setting fee scales and determining fee variations. In accordance with requirements we will publish the 2021/22 fee scale in March 2021. We will also be preparing to consult on the 2022/23 fee scale in the autumn and determining fee variations for audit years 2019/20 and 2020/21 during 2021 and 2022.

Appendix – Fee variation consultation Q&As

Question	Answer
National fee variations	
1.	Will PSAA provide more detailed information on the approach to national variations?
	PSAA has commissioned a programme of research to assess the potential suitability for national determination of a series of forthcoming changes in audit requirements, such as the introduction of IFRS 16 on leases. Where it is possible to determine a national variation, that is a national fee that would be appropriate across all, or groupings of, relevant bodies, we will consult opted-in bodies and other stakeholders on our proposals. Where it is not possible to determine a national variation, we aim to provide information for opted-in bodies and auditors on appropriate fee ranges and factors that may need to be considered.
2.	Will fees for national variations reflect the circumstances of individual bodies?
	The premise of national fee variations is that the extent of the additional work required will be similar for groups of bodies with similar characteristics, rather than being determined after assessing the position at the level of each individual body. The system will only realise the benefits outlined if audited bodies and audit suppliers accept that some estimation is implicit in this approach. Where a body can demonstrate that a particular audit requirement does not apply to them, the national variation will not be required.
3.	How will PSAA ensure that national variations are determined early, to give audited bodies as much notice as possible of additional fees?
	Some changes in audit requirements are not known in sufficient time to allow for national assessment ahead of the auditor undertaking their audit work. Our programme of research is focusing on specific planned changes in audit requirements but we will keep the topic areas under review. The aim is to assess whether a standardised fee or a fee range can be determined before audit work is required. PSAA will give notice in its consultations on national fee variations.
Local fee variations	
4.	Will PSAA provide more guidance to opted-in bodies to support local fee variations discussions?
	Information on PSAA's fee variation process including the respective roles and responsibilities of PSAA and appointed auditors is available on our website. Where PSAA is unable to determine a national fee for a particular additional audit requirement it will provide information on appropriate fee ranges and other factors to consider to support local fee variation discussions.

Question		Answer
5.	Will PSAA adjudicate where an audited body and an auditor cannot agree on a fee variation?	PSAA's process for approving fee variation requests from auditors includes careful checks and balances. Auditors are required to discuss and seek to agree any relevant proposals with an appropriate representative of the body concerned, and all proposed variations are subject to challenge and ultimate determination PSAA.
6.	Can the timetable for agreeing local fee variations be accelerated?	PSAA expects appointed auditors to discuss with audited bodies any potential need for fee variations at the audit planning stage wherever that is possible.
Fee rate increase		
7.	What is the justification for an increase of 25% in the fee rates for variations?	Current fee variation rates are significantly below market rates, including those that apply in other parts of the public sector. PSAA feels that the increase in rates is justified. The new rates remain keenly competitive compared to those payable in other sectors.
General questions		
8.	Why should additional fees be paid by bodies where auditors are focusing on technical accounting areas which add little to the quality or accuracy of the financial statements at the expense of those that impact on service delivery?	<p>The scope and requirements for auditors' work are determined by the following:</p> <ul style="list-style-type: none"> • the Code of Audit Practice and supporting Auditor Guidance Notes published by the NAO; • professional standards applicable to auditors' work set and enforced by the FRC; • financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC. <p>Auditors are required to have regard to these requirements.</p> <p>The Redmond review includes recommendations in relation to system leadership in the local audit framework and improving the transparency of accounts. MHCLG is considering the options in response to the Redmond recommendations.</p>
9.	Why are the costs of additional work for changes in audit requirements not covered by a contingency in audit contracts?	PSAA let contracts to five audit firms in 2017 for the five-year appointing period covering the audits of the accounts of opted in bodies for 2018/19 to 2022/23. The local audit framework under which the contracts were let requires appointed auditors to undertake their work in compliance with the requirements of the Code of Audit Practice. It also requires the appointing person to set audit fees based on these requirements. The legal framework recognises the potential need for additional audit work and includes a provision in the Regulations for these to be charged where needed.

Question		Answer
		As for previous audit contracts for local public bodies, the current audit contracts were let on the basis of expected local audit requirements as they were known in 2017. In the interests of safeguarding public funds, the contracts do not provide for potentially costly contingencies for changes in requirements that may or may not occur and for which the specific impact could not be quantified at the time of contract award.
10.	Why was the consultation not clear on the likely impact of changes to current arrangements from the Redmond review?	The consultation was issued in November 2020, in the period when MHCLG was considering its response to the recommendations in the Redmond review. Their policy response was published in December 2020, and further consultation proposals are anticipated in Spring 2021. PSAA is not in a position to speculate on potential changes to arrangements and is focusing on continuing to deliver its current statutory responsibilities.