

<b>REPORT TO:</b>	<b>AUDIT SUB-COMMITTEE</b>	<b>AGENDA ITEM: 12</b>
<b>DATE OF MEETING:</b>	<b>13<sup>th</sup> JULY 2020</b>	<b>CATEGORY:</b>
		<b>RECOMMENDED</b>
<b>REPORT FROM:</b>	<b>STRATEGIC DIRECTOR CORPORATE RESOURCES</b>	<b>OPEN</b>
<b>MEMBERS' CONTACT POINT:</b>	<b>KEVIN STACKHOUSE (01283 595811)</b> <a href="mailto:Kevin.stackhouse@southderbyshire.gov.uk">Kevin.stackhouse@southderbyshire.gov.uk</a>	<b>DOC:</b>
<b>SUBJECT:</b>	<b>PROPOSED EXTERNAL AUDIT FEE 2019/20</b>	
<b>WARD(S) AFFECTED:</b>	<b>ALL</b>	<b>TERMS OF REFERENCE: AS 01</b>

## **1.0 Recommendations**

- 1.1 That consideration is given to increasing the Annual Audit Fee, payable to the Council's External Auditor, as detailed in the Report.
- 1.2 That any agreed increase in the Fee is referred to the Finance and Management Committee to consider implications for the Base Budget.

## **2.0 Purpose of the Report**

- 2.1 To consider proposals from the Council's External Auditors, Ernst and Young LLP (EY) to increase their fee for 2019/20. This fee is the charge from the Auditor to discharge their statutory duty, which covers auditing the Council's accounts and financial statements, together with providing an opinion on the Council's systems for securing value for money in its use of public resources.

## **3.0 Detail**

### **Background**

- 3.1 EY are the Council's appointed Auditors under Contract whose term covers the five financial years from 2018/19 to 2022/23. EY were appointed following a national procurement exercise in 2017. This exercise was co-ordinated by the Public Sector Auditing Appointments (PSAA) an organisation set up by the Government to appoint and oversee the work of Auditors in local government.
- 3.2 As part of the procurement exercise, Auditors submitted prices for undertaking their work for the contract period. Generally, these prices were lower than the prevailing fees at that time.

- 3.3 Since 2011, Audit fees have been reducing across the sector as a more competitive market was introduced. However, in 2018/19 following the most recent procurement exercise, there was a further drop as shown in the following table.

Financial year ended	Audit Fee (£)
31 March 2011	102,600
31 March 2012	115,500
31 March 2013	64,800
31 March 2014	64,800
31 March 2015	65,700
31 March 2016	49,275
31 March 2017	49,275
31 March 2018	49,275
31 March 2019	37,942

### The 2018/19 Audit

- 3.4 The Committee will be aware that the Council's Audit for 2018/19 was delayed beyond the normal statutory deadline of 31 July 2019. The Council's accounts were signed off in November 2019.
- 3.5 As reported at the time, this was due to the inability of EY to provide sufficient resources to enable them to deliver a quality-based audit in accordance with Regulations. EY cited problems, particularly with recruitment and retention, which meant that a proportion of their clients' audits were delayed.
- 3.6 This seemed to reflect a wider problem in the local government audit sector. A record number of Audits were not delivered throughout local government by 31 July. This has led many practitioners, professionals and regulators, etc. to indicate that the pricing of current contracts was a contributing factor which is not sustainable in the longer-term.

### Audit Fees 2019/20

- 3.7 This has now led to Auditors reviewing their cost of delivering audits and submitting revised prices to local authorities. The PSAA for their part, have notified authorities of scale fees for 2019/20 (as per the Contract) and have effectively left each authority to agree any variation to that fee locally.
- 3.8 The Council's scale fee for 2019/20 is £37,942. EY have submitted proposals for the fee to be increased to £62,558. This is an increase of £24,616 and is detailed in the following table.

Additional Fee for Increase in Client Risk	£	
1 additional significant risk present	1,953	Revenue/expenditure recognition (per Audit Plan)
4 additional other risk present	3,905	Valuation of PPE, Pensions, IFRS 16, Going Concern
1 additional VFM risk present	2,561	Financial Resilience (per Audit Plan)
	<b>8,419</b>	

**Additional Fee for Increase in Regulatory Compliance**

Increase in overheads	6,815	Includes the increase in the Levy
Additional property valuation requirement	7,265	Specialists to support audit of PPE - per asset base
Additional Pension requirements	1,251	Specialists to support audit of actuarial assumptions

**15,331**

**Additional fee for client readiness and tech**

Quality of working papers and response from team	<b>866</b>
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**Total Additional Fee (including additional levy)      24,616**

- 3.9 In principle, the increases above are not just specific to the Council but are relevant across the sector due to an increase in and strengthening of, accounting standards.
- 3.10 Auditors have been keen to express that since the procurement exercise in 2017, the requirements on them have increased due to these standards, together with the changing landscape in local government.
- 3.11 This has meant additional testing to provide the relevant assurance, together with additional work on assessing the financial resilience of local authorities.
- 3.12 In addition, the deadline for auditing the accounts has been brought forward from 30 September to 31 July each year and this has also impacted on the ability of Auditors to provide their opinion on a timely basis.

**The Use of Specialists**

- 3.13 The biggest increase proposed by EY relates to the use of specialists to test property valuations and actuarial assumptions for pension disclosures. This is in addition to the costs incurred by the Council to obtain these valuations.
- 3.14 EY have stated that they need to employ specialists outside of their core team to appropriately challenge numbers and assumptions to comply with accounting standards.

**The Levy**

- 3.15 This is a payment the Auditors are required to make to the PSAA and is included in their fee.
- 3.16 It should be noted that the PSAA have traditionally reccredited a proportion of the levy back to local authorities and the Council received £5,500 in 2019/20. As this is not guaranteed each year, the Council does not budget for any contribution. Therefore, any credit received offsets the overall cost of Audit.

**Options**

- 3.17 The Council is under no obligation to pay any other fee other than that advised by the PSAA, i.e. the tendered fee from the procurement exercise in 2017. At the other extreme, it has the option of accepting the proposals by EY, or even negotiating an alternative fee through compromise, including for example, a phased increase over the remaining term of the Contract.

- 3.18 It should be noted that EY are not able to provide any guarantee in the short-term that the timeliness of the Audit will improve. It is understood that like other Auditors, recruitment and retention remains a problem across the sector.
- 3.19 Therefore, the Council could pay more money but effectively receive the same level of service.
- 3.20 However, consideration also needs to be given to the degree of negativity that could impact upon the Council by continuously publishing its accounts up to 8 or 9 months after the year end, albeit through no fault of its own.
- 3.21 It should also be noted that EY have already informed the Council that they will not deliver the Council's Audit of the 2019/20 Accounts until October/November. In the meantime, the Government have relaxed the deadline in any case for production of the Accounts until 30 November 2020 due to the impact of Covid-19.

### **The Wider Audit Review**

- 3.22 Due to changes in regulations and financial uncertainty, the Government have commissioned three independent reviews of Audit in the past 12 months. These have covered:
- Audit Regulation
  - The Audit Market
  - The Audit Product
- 3.23 In addition, the Government also commissioned an independent examination (*the Redmond Review*) into the quality of local authority audits and the effectiveness of local authority financial reporting. This included a fundamental review of the audit regime and local authority accounts in the light of the current situation.
- 3.24 The Redmond Report is due shortly and is expected to recommend some fundamental changes for local authority financial reporting and audit.

## **4.0 Financial Implications**

- 4.1 As detailed in the report. The Council's Budget for Audit fees is the PSAA scale fee of £37,942.
- 4.2 If the Committee agree to an increase in the current fee, it will need to be referred to the Finance and Management Committee to consider additional budgetary provision.

## **5.0 Corporate Implications**

### **Employment Implications**

- 5.1 None

### **Legal Implications**

- 5.2 None

## **Corporate Plan Implications**

5.3 None directly

## **Risk Impact**

5.4 As detailed in the report, i.e. potential risks of the Council not publishing its accounts and financial statements in a timely manner.

## **6.0 Community Impact**

### **Consultation**

6.1 None required

### **Equality and Diversity Impact**

6.2 None

### **Social Value Impact**

6.3 None

### **Environmental Sustainability**

6.4 None

## **7.0 Background Papers**

Letter from the PSAA to the Council on 20 April (**Appendix 1**)

30 April 2020

By email

Email [generalenquiries@psaa.co.uk](mailto:generalenquiries@psaa.co.uk)

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Dear Section 151 Officer and Audit Committee Chair

**Fee Scale for the Audit 2020/21 and update on 2019/20**

I am writing to notify you of your 2020/21 audit scale fee. In previous years your auditor has been required to write to you to do this. However, going forward, we have agreed with the audit firms that it is more efficient for PSAA to write out to all bodies directly.

PSAA commissions auditors to provide audits that are compliant with the National Audit Office's Code of Audit Practice ('the Code'). PSAA is required by s16 of the Local Audit (Appointing Person) Regulations 2015 (the Regulations) to set the scale fees by the start of the financial year, and we published the 2020/21 scale fees on our website on 31 March 2020. In addition to notifying you directly of your scale fee, this letter provides you with key updates and information on audit matters in these difficult times.

We wrote to all S151 officers on 12 December 2019 describing that local audit and audit more widely is subject to a great deal of turbulence with significant pressures on fees.

These pressures still apply, and the key aspects are summarised below.

- It is apparent that the well publicised challenges facing the auditing profession following several significant financial failures in the private sector have played a part. As you know, these high profile events have led the Government to commission three separate reviews - Sir John Kingman has reviewed audit regulation, the Competition and Markets Authority has reviewed the audit market, and Sir Donald Brydon has reviewed the audit product.
- It is not yet clear what the long-term implications of these reviews will be. However, the immediate impact is clear - significantly greater pressure on firms to deliver higher quality audits by requiring auditors to demonstrate greater professional scepticism when carrying out their work across all sectors – and this includes local audit. This has resulted in auditors needing to exercise greater challenge to the areas where management makes judgements or relies upon advisers, for example, in relation to estimates and related assumptions within the accounts. As a result, audit firms have updated their work programmes and reinforced their internal processes and will continue to do so to enable them to meet the current expectations.

## How we set your scale fee

We consulted on the 2020/21 Scale of Fees in early 2020 and received a total of 54 responses. We published the final document on our website ([Scale fee document](#)). In it we explained that although we have set the scale audit fee at the same level as for 2019/20, we do not expect the final audit fee to remain at that level for most if not all bodies because of a variety of change factors, the impact of which cannot be accurately or reliably estimated at this stage.

The impact of these changes is likely to vary between bodies depending on local circumstances, and information to determine that impact with any certainty is not yet available. Our view is that it would also be inappropriate to apply a standard increase to all authorities given the differing impact of these changes between bodies. As the impact of these changes is understood, fee variations will need to be identified and agreed reflecting the impact on each audit.

	<b>Scale fee for the audit 2020/21</b>	<b>Scale fee for the audit 2019/20</b>
South Derbyshire District Council	£37,942	£37,942

As well as the Scale of Fees document, we have also produced a [Q&A](#) which provides detailed responses to the questions raised as part of the consultation. We will update the Q&As periodically to take account of ongoing developments affecting scale fees.

The fee for the audit is based on certain assumptions and expectations which are set out in the [Statement of Responsibilities](#). This statement serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and of the audited body begin and end, and what is to be expected of both in certain areas.

The final fee for the audit will reflect the risk-based approach to audit planning as set out in the Code. Under the Code, auditors tailor their work to reflect local circumstances and their assessment of audit risk. This is achieved by assessing the significant financial and operational risks facing an audited body, and the arrangements it has put in place to manage those risks, as well as considering any changes affecting audit responsibilities or financial reporting standards.

## Fee Variations

As noted above, we recognise that with so much turbulence and change in the local audit environment, additional fee variations are likely to arise for most if not all bodies.

The amount of work required on arrangements to secure VFM is a matter of auditor judgement and is based on the requirements set out in the new Code and supporting guidance which will be published later in 2020. Once the Auditor Guidance Notes have been published we will be able to consider the impact of the new requirements in more depth, and may be able to provide indicative ranges in relation to the likely fee implications for different types and classes of body.

Given that local circumstances at each audited body are key to determining the assessment of risk and the audit work required, we would encourage early dialogue with your auditor to determine any related implications for fees. The process for agreeing fee variations begins with local communication, and ideally agreement. We have produced a fee variation process note which is available on our website ([Fee variations process](#)). Please note that all fee variations are required to be approved by PSAA before they can be invoiced.

## **Quality of Audit Services**

We are committed to do all we can to ensure good quality audits and a high-quality service for the bodies that have opted into our arrangements. The service that you can expect to receive from your auditors is set out in their Method Statement, which is available from your auditors.

Whilst professional regulation and contractual compliance are important components of the arrangements for a quality audit service, so too is the aspect of relationship management. We recently commissioned a survey via the LGA Research team to obtain audited bodies' views of the audit service provided to them. The themes and improvement areas from the survey will be discussed with firm contact partners for development at a local level. The results from our 2018/19 survey of all opted-in bodies will be available on our website in May and we will notify all S151 officers and Audit Committee Chairs.

## **Impact of COVID-19 on current 2019/20 audits**

The global COVID-19 pandemic has created further turbulence impacting on all aspects of the economy including the public sector. There are potentially significant repercussions for the delivery of audits, audit-related issues, and delays to signing audit opinions for 2019/20. MHCLG has acted to ease these pressures by providing more flexibility in the 2019/20 accounts preparation and auditing timetable by temporarily revising the Accounts and Audit Regulations. This has extended the period which an authority has to publish its draft financial statements until 31 August, and importantly there is much greater flexibility for the public inspection period as it is now required to start on or before the first working day of September 2020. The revised date for publishing audited accounts (if available) is 30 November 2020.

We recommend that you discuss with your auditors the use that can be made of this flexibility in meeting mutual governance and assurance responsibilities, noting that in a letter to all local authority Chief Executives on 22 April, MHCLG encouraged approval of pre-audit accounts earlier than 31 August if possible.

We have referred to the importance of audit quality in this letter, and just as important is the quality of the pre-audit financial statements and the working papers that are prepared by bodies. The disruption caused by COVID-19 will impact on areas of judgement and creates uncertainty in preparation of the financial statements, and it is key that bodies ensure there is sufficient focus upon financial reporting and related processes and controls, and that the planned timetable allows for sufficient internal quality assurance and review of financial reporting issues taking into account the wider impact of the pandemic on the officers' time.



## **Local Audit Quality Forum**

Our Local Audit Quality Forum focuses on providing information to support audit committees (or equivalent) in delivering their remit effectively. We are disappointed that we are not able to host our planned event this summer due to the COVID-19 pandemic. However, we plan to host our next event towards the end of the year. It will provide an opportunity to discuss a range of relevant topics and themes. If there are any particular areas you would like to see included on a future agenda, or if you wish to raise any other issues with PSAA, please feel free to contact us at [generalenquiries@psaa.co.uk](mailto:generalenquiries@psaa.co.uk)

Your auditor will, of course, be best placed to answer any questions you may have regarding your audit.

Yours sincerely,

Tony Crawley  
**Chief Executive**