

Redmond Review response - Changes to the Local Audit (Appointing Person) Regulations 2015

A submission by:
The Chartered Institute of Public Finance and Accountancy

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CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

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Introduction

CIPFA is pleased to respond to this consultation which looks at amending the Local Audit (Appointing Person) Regulations 2015.

PSAA data shows that approved audit fee variations increased from 7.54% of scale fee in 2016/17 to 13.81% of scale fee in 2018/19, representing an absolute increase of 22.1%¹. CIPFA notes that the Redmond Review highlighted dissatisfaction with the system for fee variations from some audit firms and local authorities. In particular, local auditors expressed concern that the fee variation process is not sufficient to meet their needs², while local authorities expressed concern that fee variations increase uncertainty³ and that fee variations requests are not always supported by sufficient evidence of additional work performed by auditors⁴. CIPFA therefore acknowledges the need for consultation on the fee variation process given the current operating conditions in the local audit market.

CIPFA notes that currently, fee scales must be set before the start of the financial year to which the scale of fees relates. CIPFA understands the point in the consultation document that the deadline for setting fee scales falls so far in advance of the audit work being completed that the appointing person is not always able to assess relevant regulatory and policy changes before setting the fee scales, and that these timings have contributed to the increase in requests for fee variations. This creates uncertainties for local government bodies and audit firms as the scale fee is effectively an interim figure. CIPFA welcomes the emphasis in these proposals on creating certainty for all parties, in particular for local government bodies.

Please see below CIPFA's responses to the individual questions in the consultation.

QUESTION 1

Do you agree with the above proposal to extend the regulatory deadline by which the scale fees need to be set to enable the appointing person (PSAA Ltd) to take into account more up-to-date information?

RESPONSE

Yes, CIPFA agrees with the above proposal.

Considering our above comment, generally CIPFA agrees that it is preferable to delay the date by which fee scales are set in order to allow consideration of more, and more up-to-date, information when determining fee scales. CIPFA agrees that this will allow the appointing person time to better reflect on new policies and regulations, and on the reasons why fee variations were approved on the most recent audits when setting fee scales for upcoming audits.

CIPFA notes that the consultation suggests fee scales should be set no later than 30 November of the financial year to which the fee scales relate (paragraph 3). Local government bodies need a clear idea of fee scales in sufficient time to plan. Any delay in setting the fee scales would cause problems for local government bodies when planning for the upcoming financial year. CIPFA is of the view that local government bodies are better placed to advise on whether a deadline of setting fee scales by 30 November would be early enough for them to manage substantial variances. However, CIPFA would recommend that, whatever date is agreed on, a firm deadline for setting fee scales should be included in the updated Local Audit (Appointing Person) Regulations to provide certainty to local government bodies and their auditors.

¹ Data from the PSAA Audit Contract Monitoring Report Data Pack December 2020, available at <https://www.psa.co.uk/wp-content/uploads/2021/02/Q3-Contract-monitoring-data-pack.pdf>

² Redmond Review paragraph 3.4.3

³ Redmond Review paragraph 3.4.6

⁴ Redmond Review paragraph 3.4.4

QUESTION 2

Do you agree with the above proposal to enable the appointing person to consult on and agree standardised fee variations to be applied to all or groups of principal bodies?

RESPONSE

Yes, CIPFA agrees with the above proposal.

CIPFA agrees in principle with that this proposal, noting that it would lead to a more efficient process than negotiating every fee variation separately, while acknowledging that local negotiations/discussions will still be required for entity-specific variations. However, CIPFA would expect that the need for standardised fee variations will be reduced if the deadline for setting fee scales is extended. That is, if the appointing person can take more information into account when setting fee scales, including more up-to-date regulations and policies, there should be less need for fee variations. Therefore, in conjunction with an extension to the deadline for setting fee scales, CIPFA would anticipate that the appointing person will only need to make limited use of any ability to negotiate fee variations on a group basis.

CIPFA notes that the appointing person would be required to consult in line with its consultation principles before a variation is agreed. Specifically, the appointing person will be required to conduct research to establish that a standardised (rather than a locally agreed) fee variation is appropriate. Following this, the appointing person will be required to consult with affected bodies and firms. The efficacy of the consultation process in reflecting proper distribution of audit fees is key to CIPFA's agreement with this proposal, as it ensures fee variations cannot be unreasonably imposed on local government bodies. CIPFA would caution that any system should be sensitive enough to ensure that sub-groups of authorities or bodies will not be disadvantaged by any standardised fee variations.

QUESTION 3

National fee variations could only be implemented in prescribed circumstances, which would be defined in the regulations. Do you have any comments on the example circumstances outlined in paragraph 8, or any additional circumstances that should be considered?

RESPONSE

Paragraph 8 makes reference to "National variations – for changes that relate to the conduct of most or all audits such as changes to audit and accounting codes, financial and regulatory requirements – i.e. where a standard cost can be reasonably estimated".

CIPFA believes that these examples cover the key drivers for changing fees nationally and would be a useful inclusion in the regulations. However, CIPFA believes that establishing a principles-based approach for determining the circumstances in which a national fee variation could be implemented would be preferable to a rules-based approach such as a list of prescribed circumstances. A principles-based approach would avoid a situation in which a standardised variation would be the preferred approach, but may not be permissible because the situation had not been included on the list of prescribed circumstances for which a standardised variation would be allowed. CIPFA would recommend adoption of a principle to apply rather than adoption of a list of prescribed circumstances. Rather than including a list of prescribed circumstances, the following principle could be stated:

"National fee variations are only permissible in situations where:

- The appointing person's research into the matter suggests a national variation is the preferred approach;
- A consultation is held with the affected bodies, after which the appointing person will review the implementation of a national fee variation in light of the feedback received; and

- The outcomes of the appointing person’s research and the responses to the consultation are published.”

QUESTION 4

Do you have any comments about the above proposals to enable some fee variations for additional elements of work to be approved during the audit, noting that the appointing person’s scrutiny processes to review the proposed additional fees would operate in all cases in the usual way?

RESPONSE

As noted in CIPFA’s response to the recent consultation on changes to the audit fees methodology for allocating £15 million to local bodies, local audit offers a critical check and essential source of assurance in our systems of local democracy and public accountability. Auditors provide an independent professional opinion on the financial statements of organisations responsible for spending billions in public money. Auditors also provide assurance around the arrangements these organisations have in place for achieving economy, efficiency and effectiveness in their use of resources. Providing sufficient resources to allow high quality local audits is therefore essential.

CIPFA notes that paragraph 15 of the consultation states that “The number of fee variations has increased significantly following on from the drive to improve audit quality”. CIPFA is concerned that the implication is current scale fees do not always allow for sufficient resource for high-quality audits to be conducted. CIPFA notes that the Redmond Review identifies the reduction in audit fees as a proportion of local authorities’ net current expenditure as a possible contributing factor to the resource and skills shortage in local audit. While the size of audit fees is beyond the scope of this consultation, CIPFA highlights its view on the size of local audit fees as articulated in responses to other public consultations.

With respect to Question 4, CIPFA agrees that it is reasonable to allow fee variations during the audit, noting that the appointing person’s usual scrutiny processes will be followed to verify the genuine nature of the fee variation. CIPFA notes paragraph 3.4.4 of the Redmond Review, which highlights concern from a “not insignificant” number of local authorities that fee variation requests are not always supported by evidence of additional work performed. CIPFA would therefore reiterate the importance of following scrutiny processes for fee variation requests, either during or following the audit.

QUESTION 5

Do you agree with the above proposal that the appointing person is able to appoint auditors for the period that it considers to be the most appropriate, up to the maximum length of the appointing period subject to consultation with the relevant bodies?

RESPONSE

Yes, CIPFA agrees with the above proposal, but expects that the appointing person would only rarely appoint an auditor for less than the maximum five year period.

CIPFA notes that independence standards do not require auditor rotation to be more frequent than every five years. For example, paragraph 3.10 of the Revised Ethical Standard 2019 indicates that the key audit partner of a public interest client can act in that capacity for five years. Further, CIPFA would expect that it would be rare for an appointment period of less than five years to be suitable, given that the first year of an audit:

- is likely to carry additional expense for the audit client given that the auditors must undertake additional work to acquaint themselves with the client and its systems;
- has the potential for increased detection risk due to the auditor’s lack of familiarity with the client and its circumstances.

CIPFA therefore anticipates that there should only be limited circumstances in which it would be appropriate to appoint an auditor for less than five years, as doing so would create uncertainties and potentially extra expense for both auditors and their local government body clients.

Paragraph 20 of the consultation states that this proposal would “enable procurements within an appointing period, which may help maintain a sustainable supply market as losing firms do not have to wait 5 years for the chance to win another appointing person contract.” CIPFA acknowledges that this proposed measure may contribute to supporting the local audit market. However, CIPFA cautions that, in isolation, this measure is unlikely to resolve the current difficulties in the local audit market. In particular, as indicated in the Redmond Review, achieving stability of supply in the local audit market is likely to require greater consideration of local audit fees.

QUESTION 6

Finally, we would also welcome any more general comments on the proposals, including any comments relating to equalities impact or any potential for unintended consequences of any of the above proposals.

RESPONSE

While broadly in agreement with the proposals, CIPFA would comment that the proposals should not be enacted in a way that disadvantages local government bodies. Local government bodies must be able to plan, which requires certainty over audit fees. Such certainty would be driven by transparency over how fees are set and a reduction in the use of fee variations. Any system of fee variations would need to be clear and easily understandable by local government bodies. If the proposals lead to a situation in which, for example, fee scales as established in November effectively also become an interim figure to be overtaken as new information emerges and requests for fee variations are made, local government bodies would be in a situation of greater uncertainty than they are at present. Should these proposals be taken forward, careful consideration needs to be given to ensuring that deadlines for fee scales are adhered to in a meaningful way. Further, where the appointing person does anticipate that fee variations will be required, CIPFA would comment that timely updates on potential fee variations are likely to be appreciated by local government bodies.