

Addressed to Chief Financial Officers and Audit Committee Chairs for
PSAA audited bodies (Local Government, Police and Crime
Commissioners, Chief Constables, Fire and Rescue Authorities)

10th February 2020

Ref: jd/ln

Direct line: 020 7951 2195

Sent by email

Email: jdawson01@uk.ey.com

Dear Chief Financial Officer and Audit Committee Chair

Sustainability of UK local public audit

I am writing to you to address the concerns we all share regarding the timetable for financial reporting and auditing. I also want to set out our position on the audit fees determined by Public Sector Audit Appointments Limited (PSAA). This will support conversations your Audit Partner will be having with you as we plan and deliver your 2019/20 external audit. I have also reflected on the themes emerging from my attendance at the Local Public Audit Stakeholder forum last month and conversations we have had at five Chief Financial Officer fora since December 2019.

UK local public audit market context

At the end of January 2020, 85 organisations had not yet received their audit opinion on the 2018-2019 financial statements. The factors that have led to this unprecedented position are extensive, impact all audit suppliers in the PSAA contract and need to be considered by public sector finance professionals and Audit Committees. In summary, the types of issues and challenges we have seen include:

1. Financial reporting and decision making in local government has become increasingly complex, for example from the growth in commercialisation, speculative ventures and investments.
2. Some local authorities have a shortage of financial reporting skills, capabilities and weaknesses in audit readiness (including keeping pace with technological advancement in data management and processing for audit).
3. There has been a significant increase in the specialised skills, time and cost required by auditors to address regulatory expectations. This includes responding to regulator feedback and a zero tolerance on audit quality failures.
4. Public sector auditing has become less attractive as a profession, especially due to the compressed timetable, regulatory pressure and greater compliance requirements. This has

contributed to higher attrition rates in our profession over the past year and the shortage of specialist public sector audit staff and multidisciplinary teams (for example valuation, pensions, tax and accounting) during the compressed timetables.

We have increased investment in our audit quality programme, technology, compliance, talent and recruitment initiatives and will continue to do so. We are focussed on consistently delivering high quality audits, as a poor quality audit affects our reputation and yours. We are proud of having the highest quality scores of the audit suppliers in PSAA's recent audit quality report and as a firm having had no fines or sanctions imposed by the Financial Reporting Council (FRC) for any audits conducted in the past five years.

Regulatory, contractual and legal context

We support the Financial Reporting Council's (FRC) recent quality report and statements arising from recent corporate failures, which have highlighted that tight reporting deadlines are a contributory factor to audit failings and their expectation that audit firms should delay signing opinions to ensure audit quality.

Our contract with PSAA states that we will not issue an opinion where the audit is not complete.

We also believe the requirements of the Accounts and Audit Regulations 2015 have not been explained effectively to you. You are currently required to publish a statement of accounts, annual governance statement and narrative statement by the 31st July with or without an audit opinion. If you are not able to publish an audit opinion at that time, you should explain why. This means the 31st July is not a statutory audit deadline. I and your Audit Partner will support you in meeting your requirements under the 2015 regulations whilst safeguarding our high standards of audit quality.

All of these points were discussed at the recent Local Public Audit Stakeholder forum. We support the pressing need for CIPFA and the ICAEW to work with officials from the Ministry of Housing, Communities and Local Government (MHCLG) to revisit and confirm in writing their response and expectations on the timetable and requirements for financial reporting and external audit. We understand that ICAEW has asked that such measures include a relaxation of the 31st July publication deadline for the 2019/20 financial statements or a permanent change to the 2015 regulations.

Either way, we believe the current timetable and expectations for financial reporting and external audit are unsustainable and need to change.

Delivering our 2019/20 external audits

Since December 2019, I and colleague Audit Partners have had conversations with five Chief Financial Officer groups, outlining the framework we will use to plan, schedule and deliver 2019/20 external audits under the terms of our contract with PSAA. Our delivery model takes account of plans to conclude our outstanding 2018/19 external audits.

I am providing regular updates to PSAA to provide assurance on the sustainability of our delivery plan and how we are continuing to safeguard high standards of audit quality.

Because of our views on the factors driving an unsustainable timetable, to ensure we deliver the best quality audit, I have informed PSAA, NAO and Local Public Audit Stakeholder forum that we will be scheduling a number of 2019/20 external audits for completion after the 31st July 2020.

Each of our regional office leads has agreed with me a delivery plan for the 2019/20 external audits. The proposed timing of your external audit has been determined using a consistent set of principles to ensure we have a fair and equitable basis for scheduling audits before the 31st July and those afterwards. These principles include our assessment of your preparedness for audit, expectation on level of audit errors and findings, the degree of risk and complexity including any significant changes since the prior year and maximising our availability of qualified and experienced audit staff and specialists.

Audit costs and fees

I am having ongoing discussions with PSAA on the current context with local public audit and our associated costs. I recognise you already have or may wish to respond to PSAA's recent letter to Chief Financial Officers on their current approach to consulting with you on how it determines your audit fee.

I have said to PSAA that we do not believe the existing scale fees provide a clear link with both a public sector organisation's risk and complexity, and the audit profession context for cost and fee increases, including the attractiveness of audit, investment in technology, innovation and the regulatory environment. This is exacerbated by submitting a tender response in 2016/17 financial year 18 months before the delivery period for the five-year cycle we are now currently in.

Since 2016/17, the public sector audit market has changed considerably. This is not only due to the concerns I have set out above that have led to an unsustainable timetable and expectations for financial reporting and external audit, but also because:

1. Some local public audit bodies have insufficient digital and IT systems and are unable to meet the standards required of an increasingly data-driven audit. In delivering those audits, we have incurred additional costs which were not reflected in our bid for the current PSAA contract.
2. Our cost of compliance to maintain our licence to practice and maintain high quality and sustainable local public audit has doubled since 2017.
3. We need to invest over a five to ten-year cycle to recruit, train and develop a sustainable specialist team of public sector audit staff. We and other firms in the sector face intense competition for the best people, with appropriate public sector skills, as a result of a shrinking resource pool. We need to remunerate our people appropriately to maintain the attractiveness of the profession, provide the highest performing audit teams and protect audit quality.

In the face of all these unprecedented factors, we still remain committed to deliver high quality sustainable local public audit that serves the public interest and stakeholder needs. It is clear therefore that audit fees for local public audit will have to rise.

I recognise that until there are any changes to the way PSAA determines its scale fees, your Audit Partner should be communicating with you in a timely and effective fashion any proposed variations to your scale fee to reflect changes in audit scope, risks and findings.

Next steps

We welcomed the opportunity to respond to *Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England* ("Call for Views") led by Sir Tony Redmond. The Call for Views together with the National Audit Office (NAO) Code of Audit Practice ("Code") present a significant opportunity to shape the long-term sustainability of local government, police, fire and rescue service financial reporting and auditing.

Your Audit Partner will be contacting you shortly and no later than the end of February 2020 to discuss the proposed timing of your 2019/20 external audit and a current estimate of your audit fee. Once those discussions have taken place, our regional office lead and your Audit Partner will write to you to confirm our delivery plan for the office that provides your 2019/20 external audit.

I would also like to offer to join appropriate Chief Financial Officer and Audit Committee Chair forums to discuss what we are doing to improve audit quality, the wider dynamics of local public audit and the future of audit.

By March 2020, we will publish our point of view on the various reviews underway into the long-term sustainability of local government financial reporting and external audit. We are committed to working with MHCLG, NAO, PSAA and all key stakeholders that form part of the Local Public Audit Stakeholder forum in support of this aim. Your Audit Partner will be able to discuss our point of view with you and at your future Audit Committee meetings.

In the meantime, if you have any questions on this letter, please do not hesitate to contact me using the details provided.

Yours faithfully,



Janet Dawson
UK Government and Public-Sector Assurance Leader
Ernst & Young LLP