

Work programme and scales of fees 2010/11

Consultation response

Local government, housing and community safety

Probation boards and trusts

October 2009



The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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Introduction and summary

- 1 The Audit Commission consulted the local government, housing and community safety sectors and probation boards and trusts on its proposed work programmes and scales of fees for 2010/11 and indicative fee proposals for 2011/12 and 2012/13 between July and September 2009.
- 2 We received a relatively high number of responses from consultees (12 per cent, compared with 5 per cent last year). The majority of respondents greatly appreciated the Commission's recognition of the current economic climate and the subsidy for the increased audit costs arising from the transition to International Financial Reporting Standards (IFRS). However, most commented that the Commission should freeze or reduce audit and inspection fees by increasing its efficiency target or making hard choices about its priorities.
- 3 The Commission has now considered all responses received and has confirmed the work programmes and revised scales of fees for the local government, housing and community safety sectors and probation boards and trusts. These documents are now available on our website at www.audit-commission.gov.uk
- 4 The Commission has agreed that waiving the proposed inflation uplift in audit and inspection fees is the right thing to do, and the final scales of fees now reflect this position.
- 5 Local government pension fund audits were subject to a separate full audit and scale fee for the first time in 2008/09. To enable us to confirm that the assumptions used in setting the first scale fee for the pension fund audits were reasonable we have deferred setting the 2010/11 scale fee until the 2008/09 audits have been completed and we can review the actual costs incurred in carrying these out.
- 6 This report summarises the feedback received to our consultation and our response to the key issues raised by respondents.

1 Background

- 7 Under section 7 of the Audit Commission Act 1998 and section 12 of the Local Government Act 1999, the Commission has a statutory duty to prescribe scales of fees for the audit of accounts, and for inspections. Before prescribing any scales of fees it consults audited and inspected bodies (AIBs) in the local government sector and their representative associations, and the accountancy profession. Once the Commission has prescribed a scale of fees, the applicable fee becomes payable by the body.
- 8 The Commission's income must cover the cost of its work in the local government, housing and community safety sectors and at probation boards and trusts. This comprises:
 - procuring and delivering audits;
 - delivering inspections and related functions;
 - the Commission's programme of national studies;
 - the Commission's other statutory functions – for example, the appointment of auditors; and
 - other corporate management costs.
- 9 In setting scales of fees we have to consider:
 - our responsibility to ensure that auditors have appropriate resources to meet their statutory and professional responsibilities;
 - our statutory duty, taking one year with another, to balance expenditure and income for each sector – local government and health;
 - the expectations of government and other stakeholders; and
 - the affordability of any increase.

2 The consultation

- 10** In the spirit of openness and transparency we consulted all AIBs as well as statutory consultees on our proposals. This enabled individual bodies to contribute fully to any views expressed by their representative bodies or to comment directly to the Commission.
- 11** The proposed fee increases for 2010/11 consulted on were:
- an overall increase in audit and inspection fees of 1.25 per cent for inflation, after allowing for efficiency savings of 3 per cent, which would affect all audited and inspected bodies;
 - an increase in scales of audit fees to reflect the additional audit costs arising from the introduction of IFRS of 6 per cent at local authorities, police authorities and fire and rescue authorities, and of 8 per cent at pension funds;
 - a net reduction in audit fees of 1 per cent at probation boards and trusts to reflect the decrease in the ongoing audit costs arising from the transition to IFRS; and
 - a change to the range within which we would normally consider varying the scale audit fee. In recent years the range has been 30 per cent above or below the scale fee. We proposed narrowing this range to 20 per cent above and 10 per cent below the scale fee over the next three years.
- 12** The indicative fee proposals for 2011/12 consulted on provided for:
- increases in line with the government's inflation target, adjusted to reflect ongoing internal efficiencies; and
 - reductions to reflect the lower ongoing audit costs arising from the adoption of IFRS of 3 per cent for local authorities, police authorities and fire and rescue authorities, and of 5 per cent for pension funds.
- 13** The indicative fee proposals for 2012/13 consulted on provided for:
- increases in line with the government's inflation target, adjusted to reflect ongoing internal efficiencies.

3 Respondents' views

14 We invited responses to the consultation from 589 AIBs and other stakeholders and received 71 responses (12 per cent). The response rate was higher than last year when only 5 per cent of consultees responded. The responses were made up as follows.

- Sixty-seven from local government and community safety sector bodies (12 per cent).
- Four from other stakeholders or representative bodies (31 per cent), as set out below.

Table 1 Summary of responses to the consultation

Consultees	Number of AIBs or other consultees	Number of responses	%
Local government (councils)	392	44	11
Police (AIBs)	36	1	3
Probation (AIBs)	37	8	22
Fire (AIBs)	30	5	17
Local government (other AIBs) ¹	45	5	11
Local government (other stakeholders)	32	4	13
Local government subtotal	572	67	12
Other stakeholders (general)	4	0	0
Firms and accountancy bodies	13	4	31
Total	589	71	12

Note 1: Other AIBs include those where the fee is individually determined.

15 The main theme running through the responses was that the proposed increases of 1.25 per cent (and 4.25 per cent for certification claims and returns) could not be justified in the current economic climate.

16 A number of the comments were specific and we have responded directly to the body concerned. However, a number of common themes ran through the responses.

3 Respondents' views

Overall increase

- 17 The majority of AIBs which responded considered that the Commission should freeze or reduce audit and inspection fees by increasing its 3 per cent efficiency target. Local government respondents considered that the 1.25 per cent inflation uplift to audit and inspection fees and the 4.25 per cent increase in hourly rates for certification work were out of line with actual inflation rates. Respondents pointed to the severe constraints on expenditure being experienced across the public sector and made clear their expectation that the Commission should operate under similar constraints for the next few years.
- 18 In particular, the Local Government Association (LGA) commented that the proposed fee increases were unacceptable given the challenging financial outlook for local authorities, and it considered that the Commission should be doing more to demonstrate that it is subjecting itself to the same disciplines as audited bodies.
- 19 Similarly, Communities and Local Government (CLG) has recognised the Commission's inflation drivers but would have expected the Commission's assumed inflation rate to have changed.
- 20 In responding to comments about the overall level of fee increase, the Commission has had to bear in mind that from 2010/11 it is requiring auditors to absorb the increased costs arising from the additional mandatory requirements of the new, 'clarified' international auditing standards. We currently estimate that this will result in a significant increase in audit inputs, which will have to be offset by increases in audit efficiency. Against this background the proposed increase was justifiable.
- 21 However, in the current economic context, the Commission agrees that waiving the proposed inflation uplift in audit and inspection fees is the right thing to do, and the final scales of fees now reflect this position.

IFRS

- 22 The Commission's decision to provide a subsidy to AIBs to cover the increased audit costs arising from the transition to IFRS has been well received by most respondents, including CLG. However, many respondents also suggested that the Commission should continue to subsidise the ongoing IFRS costs through increased efficiency or simply by making hard choices about priorities.
- 23 Given the other pressures on audit costs, it is not practicable to continue the IFRS subsidy on an ongoing basis through the scale of fees. It is important to retain a clear link between the statutory scale fee and the economic cost of delivering an audit that complies with professional and statutory requirements. The real increase in ongoing audit costs arising from the transition to IFRS can only be absorbed by making significant changes in the Commission's requirements of its appointed auditors – for example, by reducing the scope of local value for money work.
- 24 However, we are committed to carrying out a fundamental review of our current approach to local value for money audit work, including Use of Resources, with a view to making changes with effect from 2010/11.

Local government pension fund fees

- 25** Pension fund audits were subject to a separate full audit and had a separate scale fee for the first time in 2008/09. We have received a number of queries and complaints regarding the fee scales for pension fund audits during the 2008/09 year and during our consultation on the 2010/11 scale fees. Audited bodies have suggested that the scale fees for pension fund audits have been set too high and are inflexible.
- 26** Therefore, we have deferred the setting of the fee scales for pension fund audits until the 2008/09 audits have been completed and we can review the actual costs incurred in carrying these out. We expect final fee information for 2008/09 audits to be available in December 2009 and the scale fees for 2010/11 to be finalised early in 2010. The 2009/10 scale fee will also be reviewed for reasonableness at this time.

Narrowing the fee range

- 27** The principle of narrowing of the range within which we would normally consider varying the scale audit fee – reducing the range as a means of providing more certainty over audit fees – was supported by CLG, some responding AIBs and the firms.
- 28** However, a majority of AIBs and the LGA considered that this would reduce the ability for high-performing bodies to obtain lower fees. These comments reflect a misunderstanding of the purpose of the range. Setting the bands more narrowly will not lead automatically to increases or decreases in audit fees for the bodies affected, and we do not expect all audit fees to fall within the new narrower bands. Where it can be justified, in terms of audit risk, it will continue to be possible to agree a fee outside the range.

Transparency of fee movements

- 29** A number of AIBs have raised concerns about the transparency of the way the audit fee scales are derived. The scale fee represents the fee required to audit an average audited body of each type, with a sound control environment and no specific audit risks. The revised scales have been developed on the basis of the scales for 2009/10, uplifted by the proposed 6 per cent increase to reflect the additional audit costs arising from the transition to IFRS in local government. Probation boards' and trusts' fees have been reduced by 1 per cent to reflect the reduction in IFRS costs.
- 30** The scale fees for transport bodies and other principal bodies have been developed on the basis of 2009/10 planned fees to ensure we continue to address some anomalies in the scale fees for these types of AIBs.

3 Respondents' views

Inspection fees

- 31** We received a small number of responses from AIBs and the LGA to our proposal to increase inspection fees by 1.25 per cent. All respondents suggested that the costs need to be reduced. Respondents considered that the Commission should be taking more of a risk-based approach when developing the inspection work programme, or challenge the statutory requirements governing this work in order to reduce the burden being placed on inspected bodies.
- 32** The LGA further commented that the consultation document did not consider the ongoing impact of Comprehensive Area Assessment (CAA) on audit and inspection fees for high performing audited bodies. The LGA expected that the application of a proportionate approach to audit and assessment would lead to a lighter touch approach for higher performing bodies. It also considered it inappropriate for the Commission to carry forward the standard 40-day inspection model for risk-triggered inspections. In the context of CAA it suggested that any risk-triggered inspection activity should be much more clearly targeted and focused and, as a result, involve a significant reduction in the number of days involved.
- 33** The Commission's income from inspection fees has already reduced significantly under CAA. Comparing the final full year of Comprehensive Performance Assessment (CPA) (2007/08) with the first year of CAA (2009/10), our inspection fee income has reduced from £11.7 million to £6.74 million. We expect our 2010/11 inspection fee income to continue at the same level as 2009/10.
- 34** From 2010/11, we will take a proportionate approach to all elements of CAA, placing maximum reliance on any evidence of efficient and effective delivery of outcomes. We will assess the impact of action taken to improve performance and outcomes, updating earlier assessments and taking account of longer-term evidence and trends as they become available.
- 35** We limit the level of risk-based inspection activity we will undertake annually to keep down inspection fees to local authorities. Inspections triggered under CAA will therefore target only the highest-risk services or outcomes for inspection. The standard 40-day inspection model provides an illustration of the cost of a standard risk-based inspection only. Each inspection we undertake will be scoped to take account of the nature of the work, possibly across a number of councils, and whether we carry out such inspections as a single inspectorate or a partnership of two or more inspectorates. The scoping process may result in inspections requiring fewer or more days than the standard model. This will be fully discussed with each of the councils involved.
- 36** Under CAA, high performing authorities, where risk-based inspection is not required, will only pay an inspection fee for their managing performance assessment. This represents a considerable saving for single-tier and county councils compared with inspection fees under CPA.

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For further information on the work of the Commission please contact:

Audit Commission

1st Floor
Millbank Tower
Millbank
London
SW1P 4HQ

Telephone: 0844 798 3131

Fax: 0844 798 2945

Textphone (minicom): 0844 798 2946

www.audit-commission.gov.uk



Audit Commission

1st Floor
Millbank Tower
Millbank
London
SW1P 4HQ

Telephone: **0844 798 1212**
Fax: 0844 798 2945
Textphone (minicom): 0844 798 2946

www.audit-commission.gov.uk