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Dear Andrew

Audit scope and additional work 2019/20

I hope you and your colleagues are all keeping safe and well in these very unusual and difficult times. In this letter, I want to continue to update you on our plans to work with you over the coming months, as we have discussed at our most recent weekly meetings. I want to ensure that we plan our audit effectively, to provide assurance for those charged with governance, and to deliver a high quality audit to all users of the audit, whilst seeking to maintain our fee within the envelope which we have recently been discussing with you. The letter therefore aims to support the commentary relating to the fee that is currently within the draft audit plan for 2019/20 and to ensure transparency. I know that we have discussed the fee on a number of occasions and I would want to continue those discussions relating to the forecast for 2019/20.

Global events have moved in an unexpected and tragic direction and none of us could have foreseen the impact that the Covid19 crisis has had on the world. As a local government body, you are at the forefront of efforts to support local people, and clearly the focus of the Authority will be directed to supporting local communities as best you can in these exceptionally difficult circumstances. As your auditors, we absolutely understand the challenges that you and your teams are facing and we have already been discussing with you and your team how we can work with you as effectively as we can. At these challenging times it is even more important to ensure that we can deliver a high quality audit, focused on good governance and the application of relevant accounting and auditing standards, whilst recognising the day to day pressures you face.

In recent conversations, including at Plymouth City Council, and the Audit and Governance Committee, we have discussed the increased regulatory focus facing all audit suppliers and the impact this will have on the scope of our work for 2019/20 and beyond. You will have also received a letter via email from Tony Crawley of PSAA in December 2019 explaining the changing regulatory landscape. In his letter, Mr Crawley highlights: "*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.*"

I wanted to ensure that I set out in more detail the likely impact of this on our audit, and I am pleased to do so in this letter. Should further matters arise during the course of the audit they could also have fee and timetable implications that we would need to address at that point.

Across all suppliers and sectors (public and private), the Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge, as well as to undertake additional and more robust testing. There is a general 'raising of the quality bar' following a number of recent, high-profile company failures that have also been attributed to audit performance. Alongside the FRC, other key stakeholders including the Department for Business, Energy and Industrial Strategy (BEIS) have expressed concern about the quality of audit work and the need for improvement. The FRC has been clear to us that it expects audit quality in local audit to meet the same standards as in the corporate world and the current level of financial risk within local audit bodies supports this position.

As a firm, we are absolutely committed to meeting the expectations of the FRC and other key stakeholders with regard to audit quality and public sector financial reporting. To ensure the increased regulatory focus and expectations are fully met, we anticipate that, as first seen in 2018/19, we will need to commit more time in discharging our statutory responsibilities, which will necessitate an increase in costs. I set out below the implications of this for your Authority's audit.

Increased challenge and depth of work – raising the quality bar

The FRC has raised the threshold of what it assesses as a good quality audit. The FRC currently uses a four-point scale to describe the quality of the files it reviews, as follows:

Score	Description
1 or 2a	Acceptable with Limited Improvements Required
2b	Improvements required
3	Significant Improvements Required

Historically, the FRC's definition for 2b was 'acceptable but with improvements required' and, as such, both the Audit Commission and PSAA considered a '2b' to represent an acceptance level of audit quality for contract delivery purposes. The FRC has now set a 100% target for all audits (including local audits) to achieve a '2a'. Its threshold for achieving a '2a' is challenging and failure to achieve this level is reputationally damaging for individual engagement leads and their firm. Non-achievement of the standard can result in enforcement action, including fines and disqualification, by the FRC. Inevitably, we need to increase the managerial oversight to manage this risk. In addition, you should expect the audit team to exercise even greater challenge of management in areas that are complex, significant or highly judgmental. We will be required to undertake additional work in the following areas, amongst others:

- use of specialists
- information provided by the entity (IPE)
- journals
- management review of controls
- revenue
- accounting estimates
- financial resilience and going concern
- related parties and similar areas.

As part of our planning, we have also reflected on the level of materiality which is appropriate for your audit. As outlined above, the profile of local audit has increased considerably over the past year. The reviews led by Sir John Kingman, Sir Donald Brydon and Sir Tony Redmond are focusing attention on the work of auditors everywhere. Parliament, through the work of its Scrutiny Committees, has made clear its expectations that auditors will increase the quality of their work. Reflecting this higher profile, and the expectations of stakeholders, we propose to reduce the materiality level for all major audits. For Plymouth City Council this will lead to a reduction from 1.7% to 1.33% of gross revenue expenditure, reflecting both the increased focus on large audits and our experience from the 2018-19 audit. This will increase the volume and scope of our testing and reporting to those charged with governance, as well as providing you with additional assurance in respect of the audit.

As a result, you may find the audit process for 2019/20 and beyond even more challenging than previous audits. This mirrors the changes we are seeing in the commercial sectors.

Property, plant and equipment (PPE or 'Fixed Assets')

The FRC has highlighted that auditors need to improve the quality of audit challenge on Property, Plant and Equipment (PPE) valuations across the sector. We will therefore increase the volume and scope of our audit work to ensure an adequate level of audit scrutiny and challenge over the assumptions that underpin PPE valuations. We have also determined that, for major local audits, we will now be engaging our own external valuer to provide appropriate assurance to the standards expected by the FRC.

Pensions (IAS 19)

The FRC has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Specifically, for the following areas, we will increase the granularity, depth and scope of coverage, with increased levels of sampling, additional levels of challenge and explanation sought, and heightened levels of documentation and reporting. Our planned additional procedures include:

- verification of the accuracy and completeness of the data provided to the actuary by both the admitted body and the administering authority
- checking the value of the Pension Fund Assets at 31 March per the Authority's financial statements against the share of assets in the Pension Fund statements
- review and assess whether the significant assumptions applied by the actuary are reasonable and are followed up on areas identified by either our review or PwC as outliers
- ensuring that the instructions from the audit team to the Pension Fund auditor include enquiries in respect of service organisation reports as well as testing in respect of material level 3 pension assets (please note that this is outside the scope of PSAA's fee variation process)

Complex accounting issues and new accounting standards

You are required to respond effectively to new accounting standards and we must ensure our audit work in these new areas is robust. There is a requirement, under IAS8, to disclose the expected impact of changes in accounting treatment in the financial statements.

We know the Authority has appreciated our responsiveness in the past and we would wish to continue to be able to do this in the future.

Local issues

The audit of the Plymouth City Council's 2018-19 financial statements was the first year that Grant Thornton UK LLP were your external auditors in more recent times. Our audit identified a number of issues both in the accuracy of the figures and information reported in the financial statements and in the quality of supporting working papers. As you are aware we had to undertake a significant amount of work around the valuation of PPE and investment properties which led to prior period adjustments having to be made. Additional testing had to be undertaken on grant income, financial instrument disclosures and the validity of Trading Account income.

We also spent a number of hours in talks with you and reviewing the governance and due diligence arrangements regarding the repayment of the Pension Fund Liability through MIEL Ltd.

All of these matters required significant additional audit work to complete the audit and resulted in an additional fee to be paid.

We have continued to work with senior members of the finance team to address the issues arising during the 2018-19 audit and seek improvements to both the quality and accuracy of the financial statements and the supporting working papers produced by the Council for 2019-20. However, it is likely that there will be additional audit work arising in 2019-20 as these new arrangements become embedded and further opportunities to improve are identified. We have therefore factored in our expected additional audit work into the scope of the audit-

Covid 19

The current pandemic crisis has increased audit risk factors in the following areas:

- Remote working arrangements and redeployment of staff to critical front-line duties may impact on the quality and timing of the production of the financial statements, and the evidence we can obtain through physical observation;

- Volatility of financial and property markets will increase the uncertainty of assumptions applied by management to asset valuation and receivable recovery estimates, and the reliability of evidence we can obtain to corroborate management's estimates;

- Financial uncertainty will require management to reconsider financial forecasts supporting their going concern assessment and their overall financial resilience and whether material uncertainties for a period of at least 12 months from the anticipated date of approval of the audited financial statements have arisen; and

- Disclosures within the financial statements will require significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1, particularly in relation to material uncertainties.

We have set out in the Audit Plan the additional work we propose to undertake in respect of this new significant risk. Fundamental to our response will be working with you to understand the arrangements the Authority has in place to address relevant risks in respect of Covid 19 in its accounts preparation. We will also review the appropriateness of your disclosures, including in respect of any estimation uncertainties around for example operational property plant and equipment and Pensions asset valuations. The significance of the Council's investment property portfolio and the potential impact of the coronavirus on its valuation will require additional audit input, using an auditor's expert, which will incur further additional costs that we would need to pass onto you.

Group Audit

We anticipate that there is a likely requirement to produce Group Accounts for the first time in 2019/20. The introduction of a Group Account requires additional responsibilities on the Auditor in the way that the audit is performed and reported. For instance, the Group Auditor is required to liaise with auditors of subsidiaries, request work to be performed on specific risk areas and review the work of subsidiary auditors. There are also specific reporting requirements imposed on the Group auditor in discharging their responsibilities to both the public and Those Charged with Governance.

Value for Money and Financial Standing

As part of our VfM work we will ensure we understand the arrangements you are putting in place to manage risks around business continuity in the current pandemic crisis. We have added an additional significant risk in relation to COVID-19 as part of our initial risk assessment. We will also review your assessment of going concern and financial stability in the light of increased uncertainties around for example Council Tax and NNDR collection rates, car park income, tourist attraction income and investment returns. We envisage linking the additional VfM work around financial standing with our Going Concern opinion work.

Regulatory changes.

You will be aware that the Government accounting Financial Reporting Advisory Board (FRAB) has deferred the implementation of IFRS 16 by a year. Whilst IAS 8 disclosures will be required, this change will lead to some reduction in preparatory work required by both you and us, for this year at least.

Finally, MHCLG has revised the publication date for the draft accounts to 31 August and set a target date for publication of audited accounts of 30 November. Whilst flexibility in moving away from July is welcome, a number of authorities have highlighted the risk that a delayed closedown process could impact on their budget programme for 2021/22. We are keen to continue with the agreed timetable of a draft set of statements by 31 May 2020 and an audit target of 30th September 2020. We will continue to liaise and discuss what works for you.

Impact on the audit and associated costs

You will note we did not raise additional fees across the sector as a whole in 2018/19 in respect of the additional work required in response to the implementation of IFRS9 and IFRS15. This was a goodwill decision we took in support of the strong relationship we have with the sector. However, the volume of additional work now being required, as set out above, means we are no longer able to sustain that position. This is an issue not just across public services but also in the private sector where fees are being increased by all of the major suppliers by more than 20%.

We benefit from effective and constructive working relationships which we have established during our engagement with you to date. This allows us to absorb some of the impact of these changes. Using our strong working knowledge of you and efficiencies that we are continuously seeking to implement as part of our focus on continued collaborative working with you, we have sought to contain the impact as much as possible to below the market average.

We have assessed the impact of the above as follows for 2019/20, with the comparative position for the two previous years shown. Please note these are subject to approval by PSAA in line with PSAA's normal process. Should other risks arise during the course of the audit which we have not envisaged, we may need to make a further adjustment to the fee.

Area	Cost £		
	2019/20	**2018/19**	**2017/18**
Scale Fee	£105,393	£105,393	£136,874
Increased challenge and depth of work	£5,000	-	-
Materiality	£3,000	-	-
PPE & Valuations	£9,500	£3,000	-
Pensions	£3,500	£3,000	-
Pensions Mc Cloud	-	£3,000	
Groups	£4,000	-	-
New Standards	£3,000	-	-
Local Issues:			
Pension repayment through Miel	£6,000	£15,000	
PPE and PPA		£45,500	
Financial Instruments /CFR and Grants	£3,000	£8,000	
	£37,000	£68,500*	
Total	**£142,393**	**£173,893**	**£136,876**

* yet to be agreed by management and PSAA.

This would give a scale fee for the statutory accounts audit for 2019/20 of £105,393 plus VAT plus a variation of £ 37,000 plus VAT, giving a total fee of £142,393 plus VAT. (£173,893 plus VAT in 2018/19).

Please note that PSAA's arrangements require a separation of fees and remuneration, which means that Grant Thornton does not receive 100% of the current fees charged.

The additional work we are now planning across the whole of our portfolio will inevitably have an impact on the audit timetable and whether or not your audit can be delivered to appropriate quality standards by the 30 September Grant Thornton remains the largest trainer of CIPFA qualified accountants in the UK and is committed to continue to resource its local audits with suitably specialised and experienced staff but the pool of such staff is relatively finite in the short-term. I will be happy to explain the impact of the further work we are planning to undertake on our delivery timetable for your audit, which at this stage is planned to be delivered by 30 September 2020.

Future changes to audit scope

As I have previously mentioned in meetings and at the Audit and Governance Committee, the National Audit Office has consulted on revisions to the Code of Audit Practice and has also indicated its intention to consult on the accompanying Auditor Guidance Notes. This defines the scope of audit work in the public sector. The most significant change is in relation to the Value for Money arrangements. Rather than require auditors to focus on delivering an overall, binary, conclusion about whether or not proper arrangements were in place during the previous financial year, the draft Code requires auditors to issue a commentary on each of the criteria. This will allow auditors to tailor their commentaries to local circumstances. The Code proposes three specific criteria:

a) Financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;

b) Governance: how the body ensures that it makes informed decisions and properly manages its risks; and

c) Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

Under each of these criteria, statutory guidance will set out the procedures that auditors will need to undertake. An initial review of arrangements will consist of mandatory procedures to be undertaken at every local public body plus any local risk-based work. The consultation closed on 22 November 2019. A new Code will be laid before Parliament in April 2020 and will apply from audits of local bodies' 2020/21 financial statements onwards.

At this stage, it is difficult to cost the impact. However, as soon as the requirements are finalised and it is clear exactly what the expectations will be, I will share with you further thoughts on the potential impact on the audit and associated costs.

I hope this is helpful and allows you to plan accordingly for the 2019/20 audit. Should you wish to discuss this further, please do not hesitate to contact me. We will be sharing our detailed Audit Plan with you in due course. We look forward to working with you again this year,

Yours sincerely

Engagement Lead and Key Audit Partner

For and on behalf of Grant Thornton UK LLP