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Dear Rob

Audit Scope and Additional Work 2019/20 – Warwickshire Pension Fund

In our discussions in respect of variations to the 2018/19 audit fee you commented that, if possible, you wished to move away from their retrospective nature. As we discussed at our meeting today, in order to look to address this we will be including proposals within our detailed Audit Plan for 2019/20. I am also writing this letter to help put our views upon the growing audit scope and our assessment of the impact upon our audit work and fees into context and assist in any further discussions you may wish to have with PSAA Ltd.

In recent conversations, including at Warwickshire County Council's Audit and Standards Committee (as those charged with governance for the Fund), 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. We have shared the transcript of a letter sent via email from Tony Crawley of PSAA explaining the changing regulatory landscape with you. 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.*"

As noted above I promised I would 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 Fund'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 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.

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.

Valuation of level 3 investments (excluding directly held property)

The Financial Reporting Council (FRC) has highlighted that the quality of work by all audit firms in respect of valuations of hard to value investments needs to improve across the sector. With 10% of the Fund's assets being in Level 3 this has always been a focus of our audit and in 2018-19 we sought to absorb the costs but, accordingly, we plan to enhance the scope and coverage of our work further to ensure an adequate level of audit scrutiny and challenge over the assumptions and evidence that underpin the valuations of level 3 investments this year to fully reflect the expectations of the FRC and ensure we issue a safe audit opinion.

Provision of IAS 19 Assurances to Scheme Employer auditors

As outlined above, the FRC has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. As scheme auditor we are requested to carry out a programme of work by scheme employer auditors to provide assurances around the accuracy and completeness of data provided to the actuary. We will increase the granularity, depth and scope of coverage of our work in this area. For 2019-20 this will also include work on information provided to the actuary to support the 2019 triennial valuation.

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 IFRS 9 and IFRS 15 (whilst pension funds were not as directly impacted by the changes as administering authorities there were additional disclosure requirements and considerations). 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	Proposed Fee £	Cost £	Cost £
	2019/20	2018/19	2017/18
PSAA Scale Fee	**18,397**	**18,397**	**23,892**
Increased challenge and depth of work	2,500	-	-
Level 3 Investments Valuations	1,750	-	-
Total Additional Fee	**4,250**	**-**	
Total Revised Audit Fee	**22,647**	**18,397**	**23,892**
Audit Related Services			
Provision of IAS 19 assurances to scheme employer auditors (estimated based on prior periods plus triennial valuation)	7,000	6,000 (no triennial valuation)	£1,328 (under PSAA)
Total Audit and Audit Related Services Scheme Fee	**29,647**	**24,397**	**25,220**

This would give a scale fee for the statutory accounts audit of £22,647 (£18,397 scale fee for 2019/20 plus a variation of £4,250) plus VAT. This excludes the cost of IAS 19 assurances provided to other auditors.

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.

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. 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 all of our audits can be delivered to appropriate quality standards by the 31 July 2020. I will be happy to explain the impact of the further work we are planning to undertake on our delivery timetable for your audit but at this stage we are planning for it to be delivered by 31 July 2020.

Future changes to audit scope

As we have previously mentioned in meetings and at the Audit and Standards committee, the National Audit Office is currently consulting 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. Whilst for pension funds the assessment of these risks, if any, is undertaken at the Administering Authority level the arrangements of the Fund do still fall within the scope of the Code. The proposed Code now requires auditors to focus on delivering both an overall, binary, conclusion about whether or not proper arrangements were in place during the previous financial year, alongside issuing a tailored commentary on each of the criteria. 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. The new code was laid before Parliament on 21 January 2020 and is expected to come into force in April 2020 and will apply from audits of local bodies' 2020/21 financial statements onwards.

Until the Parliamentary process is completed consultation is finalised and more details emerge of what is expected of auditors, 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

Grant B Patterson
Engagement Lead and Key Audit Partner

For and on behalf of Grant Thornton UK LLP