

Regulatory Compliance and Quality Review Programme

Annual Report 2015

Public Sector Audit Appointments Limited (PSAA) is an independent company limited by guarantee incorporated by the Local Government Association in August 2014.

The Secretary of State for Communities and Local Government delegated statutory functions (from the Audit Commission Act 1998) to PSAA by way of a letter of delegation issued under powers contained in the Local Audit and Accountability Act 2014.

The company is responsible for appointing auditors to local government, police and local NHS bodies, for setting audit fees and for making arrangements for the certification of housing benefit subsidy claims.

Before 1 April 2015, these responsibilities were discharged by the Audit Commission.

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Introduction

1 Public Sector Audit Appointments Limited (PSAA) monitors the performance of all its audit firms. The results of our monitoring provide audited bodies and other stakeholders with assurance that high-quality audits are being delivered. We define audit quality as compliance with our regulatory requirements and with professional standards. Our objectives are to:

- provide assurance that the firms have put in place systems and processes to deliver audit work of good quality; and
- provide information to inform the audit appointments we make.

2 There are two strands to our monitoring:

- audit quality- applying our annual quality review programme (QRP) to the audit work undertaken for the year ending 2013/14; and
- regulatory compliance- reporting quarterly on audit firms' compliance with our 2014/15 regulatory requirements as set out in the Terms of Appointment^I.

3 The audit quality and regulatory compliance monitoring for 2014/15 incorporated a range of measurements and checks comprising:

- a review of each firm's latest published annual transparency reports;
- the results of reviewing a sample of each firm's audit quality monitoring reviews (QMRs) of its financial statements, Value for Money (VFM) conclusions, Whole of Government Accounts (WGA) and housing benefit (HB COUNT) work. Our review included assessing compliance with the HB COUNT guidance;
- an assessment as to whether we could rely on the results of each firm's systems for quality control and monitoring^{II};
- a review of the Financial Reporting Council's (FRC) published report on the results of its inspection of firm audits in the private sector;
- the results of our inspection of each firm by the FRC's Audit Quality Review team (AQR) as part of our commissioned rolling inspection programme of financial statements and VFM work;
- the results of each firm's compliance with 17 key indicators relating to Terms of Appointment requirements^{III};
- a review of each firms' systems to ensure they comply with our regulatory requirements^{IV}; and
- a review of each firm's client satisfaction surveys for 2013/14 work.

^I Previously these requirements were set out in the Standing Guidance for Auditors issued by the Audit Commission.

^{II} These assessments were undertaken by the Audit Commission prior to 1 April 2015.

^{III} Results of compliance against the 17 indicators were published by the Audit Commission prior to 1 April 2015.

^{IV} These assessments were undertaken by the Audit Commission prior to 1 April 2015.

- 4 In the limited assurance regime, the measurements and checks comprise:
 - the results of firms' compliance with five key indicators relating to Term of Appointment requirements;
 - a review of firms' systems to ensure they comply with PSAA's regulatory requirements;
 - the results of reviewing a sample of firms' own internal QMRs of annual return work;
 - the results of our own reviews of annual return work;
 - an assessment as to whether we could rely on the results of each firm's systems for quality control and monitoring; and
 - a review of each firm's client satisfaction surveys for 2013/14 work.
- 5 This report summarises the results of the quality review process for 2015.

Overall performance

6 In our principal and limited assurance audit regime, our monitoring of compliance with the Terms of Appointment uses a green, amber, and red scoring scheme.

7 We also use similar scoring in the principal audit regime to assess the overall quality of audit work for key aspects of the audit covering: financial statements audit work; whole of government accounts returns; VFM conclusion; and HB COUNT audit work.

8 The combined regulatory compliance and audit quality performance for each principal audit firm is detailed in Table 1.

Table 1: Combined regulatory compliance and audit quality performance scores

Green	Amber	Red
EY	BDO	
Mazars	Deloitte	
	Grant Thornton	
	KPMG	
	PwC	

9 In the limited assurance regime, we assess the overall quality of audit work on a four point scale, consistent with the scale used in our principal audit regime for individual file reviews. This scale is:

- 'Improvements required which are individually or collectively significant';
- 'Acceptable overall with improvements required';
- 'Acceptable with limited improvements required'; and
- 'Good, no improvement required'.

10 The audit quality performance for each limited assurance audit firm is detailed in Table 2¹.

¹ We do not combine regulatory compliance and audit quality performance in the limited assurance regime.

Table 2: Audit quality performance scores

Good, no improvement required	Acceptable with limited improvements required	Acceptable overall with improvements required	Improvements required which are individually or collectively significant
BDO	Grant Thornton	PKF Littlejohn	
Mazars			

11 The results of the monitoring programme show that quality has been maintained overall from last year.

12 We are satisfied that the risks of audit failure remain low; that all firms are meeting PSAA's regulatory requirements; and that all firms are continuing to produce work to an acceptable standard.

13 The firms' individual annual audit quality and regulatory compliance reports, along with their regulatory compliance reports, are available to view on the audit quality pages of our website.

Regulatory requirements- principal audits

14 Our monitoring of auditors' compliance with the Terms of Appointment focuses on 17 key indicators. These include the target dates for issuing audit opinions on the financial statements and VFM conclusions; issuing assurance reports on the whole of government accounts returns; producing annual audit letters; and sending us specified information and returns.

15 We are pleased to note that the majority of the indicators were scored as green, where the requirement was either fully met, or met within a specified tolerance.

16 Auditors met the majority of our target dates for issuing the audit opinion (100 per cent for NHS and 98.2 per cent for local government). Where they were not met, the delays were mainly for reasons that were outside the auditor's control, such as delays at audited bodies in producing financial statements.

17 The results of satisfaction surveys issued by firms for 2013/14 audit work showed that audited bodies were satisfied with their auditor. However, one area that continues to require improvement in the regime is the timely resolution of objections, from local government electors, by auditors.

QRP results- principal audits

Financial statements audit work

18 Auditors of listed companies have a statutory duty to produce an annual transparency report, giving information about the firm's governance and its arrangements for ensuring the quality of its work. All the firms in our principal audit regime are covered by this requirement and our review of the transparency reports did not highlight any significant issues of note.

19 The FRC's public reports provide an objective reality check on the self-assessments included in the firms' transparency reports. The FRC's summary report on its 2013/14 inspections of the work of the big four and 'other significant' audit firms concluded that '...the 2014/15 inspection results are consistent with our overall judgment that audit quality is improving.' (FRC Annual Report 2014/15, 29 May 2015) ^I

20 The FRC has identified a number of key issues which, profession wide, should be addressed in order to improve audit quality. Key issues included:

- a need for auditors to improve their scepticism in challenging the appropriateness of assumptions in key areas of audit judgment such as impairment testing and property valuation;
- a need for an improvement in the sufficiency and appropriateness of audit procedures being performed. This is common to many audit areas including revenue recognition; and
- a need to adequately identify the threats and related safeguards to auditor independence and to appropriately communicate these to audit committees.

21 The results of the FRC reviews on a sample of ten PSAA engagements for 2013/14 concluded that the audits had been performed to an acceptable standard overall.

22 We reviewed a sample of all firms' quality monitoring reviews (QMRs) of financial statements audits. While these identified scope for improvement, there were no systematic concerns about the overall quality of work.

Whole of government accounts returns

23 Whole of government accounts (WGA) cover the whole of the public sector. Appointed auditors have a statutory duty to review and report on the WGA returns prepared by local government bodies and police authorities. The NAO specifies the procedures that appointed auditors need to follow when receiving and reporting on the WGA return. For each firm we reviewed a sample of the quality monitoring reviews of auditors' WGA returns.

24 We were satisfied from the results of the reviews that the evidence on audit files was sufficient to support auditors' reports.

^I FRC Audit Quality Inspections Annual Report 2014/15, published 29 May 2015.

Value for money conclusions

25 Auditors are required by the National Audit Office Code to give a value for money (VFM) conclusion as to whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. For each firm we reviewed a sample of the quality monitoring reviews of auditors' VFM conclusions.

26 We were satisfied from the results of the reviews that the evidence on audit files was sufficient to support auditors' VFM conclusions. However, there continues to be scope for improving the documentation on VFM conclusion audit files of risk assessments and subsequent auditor judgements; as well as improving on the timeliness of engagement lead review of work.

Certification of HB COUNT work

27 Certification work is not an audit, but a type of assurance engagement. PSAA auditors certify local authorities' claims to provide assurance to the Department for Work and Pensions (DWP) that housing benefit subsidy claims comply with terms and conditions.

28 Auditors are required to undertake this work using specific guidance and tools which are agreed annually with the DWP. HB COUNT sets out the approach and work needed to certify the subsidy claim form and includes a requirement to test a sample of cases to check that benefits have been awarded in accordance with benefit regulations and that subsidy has been properly claimed

29 For each firm we reviewed a sample of the quality monitoring reviews of certification work to assess whether the auditor had followed our prescribed tests. We found that suppliers complied with our requirements on the whole, but there is scope for improving compliance with our certification instructions in specific areas specifically around the consideration and documentation of how prior year issues have been resolved by audited bodies.

Regulatory requirements- limited assurance audits

- 30** The limited assurance approach for smaller bodies comprises three key elements:
- a compliance check against the requirements of an annual return;
 - a high level analytical review of financial and other information requested by the auditor; and
 - a review of the bodies annual governance statement.
- 31** This work leads to the issue of a limited assurance audit opinion on the annual return and a certificate of closure.
- 32** We undertook our own reviews of a sample of limited assurance work at each firm, in addition to relying on firms' internal arrangements.
- 33** In the limited assurance regime, our monitoring of auditors' compliance regulatory requirements focuses on five key indicators. These include the target dates for issuing opinions on the annual return; and sending us accurate information and returns.
- 34** We are pleased to note that 100 per cent of the indicators were scored as green, where the requirement was either fully met, or met within a specified tolerance.
- 35** Auditors met the majority of our target dates for issuing the limited assurance opinion (99.1 per cent overall). In addition the results of satisfaction surveys issued by firms for 2013/14 audit work showed that audited bodies were satisfied with their auditor.

QRP results- limited assurance audits

Limited assurance audit work

36 Our reperformance of a sample of the internal reviews did not highlight any weaknesses in any of the firms' internal QRMs and we were able to rely on this work in addition to our own reviews.

37 Some minor improvement points were raised across all firms, both as part of the internal QMRs and from our own reviews. The more significant improvement point raised included not always having clear explanations on file of the conclusions reached when forming an audit judgement.

38 There were no systematic concerns about the overall quality of limited assurance audit work.

Responses to QRP findings and next year's QRP

- 39** All the audit firms have made arrangements to report the QRP findings to a suitable management group. Action plans are in place to address both organisation-wide and audit team issues. We will follow up significant recommendations as part of next year's QRP.
- 40** We intend to continue with our regulatory compliance reports for all suppliers. Where required, we will make visits to firms.
- 41** Our programme for next year will continue to include reviews of audit work by the FRC; and reliance on the results of firms' QMRs.
- 42** Our aim is to work with firms to ensure that our regulatory requirements continue to be met and that the risks of audit failure remain low.