

# Annual Regulatory Compliance and Quality Report

**EY LLP June 2016**

**Audit 2015/16**

**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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# Summary report

## 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 auditors within our regime are delivering high-quality audits.
- 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 2014/15; and
  - regulatory compliance- reporting quarterly on audit firms' compliance with our 2015/16 regulatory requirements as set out in the Terms of Appointment.
- 3 The audit quality and regulatory compliance monitoring for 2015/16 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) conclusion 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;
  - a review of the Financial Reporting Council's (FRC) published reports on the results of its inspection of 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 15 key indicators relating to our Terms of Appointment requirements;
  - a review of each firms' systems to ensure they comply with our regulatory and information assurance requirements; and
  - a review of each firm's client satisfaction surveys for 2014/15 work.
- 4 This report summarises the results of our monitoring work for EY LLP.

## Overall performance

5 The firm is meeting our standards for overall audit quality and our regulatory compliance requirements. We calculated the red, amber, green (RAG) indicator for overall audit quality and regulatory compliance using the principles detailed in Appendices 1 and 2. For 2015/16, EY's combined audit quality and regulatory compliance rating was Green.

Figure 1: **2016 Comparative performance for audit quality and regulatory compliance**

BDO	DT	EY	GT	KPMG	Mazars	PwC
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6 The firm has maintained its performance against the regulatory compliance indicators since last year, with all but two of the 2015/16 indicators scored as green. The firm's overall weighted audit quality score has decreased slightly from last year.

7 The satisfaction survey results show that audited bodies are satisfied with the performance of EY as their auditor.

## Detailed report

### Quality review programme

#### *FRC Inspection*

**8** Every year each firm provides a self-assessment in the form of a statutory transparency report. Our review of the EY transparency report did not highlight any significant issues of note.

**9** Annually, the FRC publishes reports on the audit firms subject to full scope FRC inspections, including firms in our regime. We place reliance on the work of the FRC, which reviews the firms' systems and processes for ensuring audit quality and reviews a sample of their audits of public interest entities. In its latest public report on the firm, the FRC concluded that audit procedures were performed to a good standard or required only limited improvements for 17 of the audit engagements reviewed, with three requiring improvement and none audit requiring significant improvement.

**10** The FRC has identified key issues in its reports which, profession wide, should be addressed in order to improve audit quality. These were:

- 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 some improvement in the sufficiency and appropriateness of audit procedures being performed on revenue recognition; and
- a need to report more thoroughly to audit committees.

**11** We have raised these issues with EY and with all other firms in our regime and we will continue to monitor progress in these areas.

**12** We also commissioned inspections of all firms by the FRC for this year's QRP. The AQR inspected two 2014/15 audit files and one VFM conclusion file from EY's PSAA work and provided an updated commentary on the applicability of firm-wide procedures to our audits. Having considered the review points raised by the AQR, we assessed the audits inspected as acceptable with limited improvements required for the financial statements audits and as acceptable overall with limited improvements required for the VFM conclusion work.

**13** The improvement points raised by the AQR, from across the firms, following this year's programme of work for PSAA were:

- clearly justify and document materiality considerations and not default automatically to the top of the materiality range;
- consider property valuations as significant risk areas, and ensure that when considering external valuers' work there is review and challenge of management assumptions. In addition, audit teams need to verify the completeness and accuracy of source data used by experts and evidence that assets are revalued on the appropriate cycle in accordance with accounting policies;
- evidence journals selected for testing by audit teams, while improving procedures to ensure the completeness of the population of journals considered for testing;
- better evidence work on asset valuations and ensure actuarial assumptions are appropriately challenged;
- ensure that VFM work covers financial resilience over an appropriate period and that the outcomes from VFM work are reporting in sufficient detail to those charged with governance.

14 We have combined our scores for the AQR inspections for PSAA with the firm's QMR scores in the relevant sections in the rest of this report. These improvement points are included in Appendix 4.

#### *QMR programme*

15 PSAA sets quality standards for its appointed auditors and monitors their performance against them. The principal means of monitoring and evaluating the quality of auditors' work is the annual QRP. For 2015/16 we relied on each firm's own quality monitoring arrangements.

16 All firms agreed to follow PSAA's methodology and reporting format for their QMRs for VFM conclusions and HB COUNT audit work and use their own methodology for assessing work on the financial statements (converting the financial statements results to our scoring system). We concluded that EY's QMRs were sufficiently detailed and rigorous for us to place reliance on all of the reviews provided by the firm.

17 Each firm scored their QMRs using a common four-point scale, with 3 being the highest and 0 being the lowest. A score of 1 is our benchmark for acceptable performance. The full assessment scale is detailed in Table 1 and we calculated the score for overall audit quality on a weighted assessment using the weightings detailed in appendix 1.

**Table 1- PSAA assessment scale**

<b>Score</b>	<b>Descriptor</b>
3	Good, no improvement required
2	Acceptable with limited improvements required
1	Acceptable overall with improvements required
0	Improvements required which are individually or collectively significant

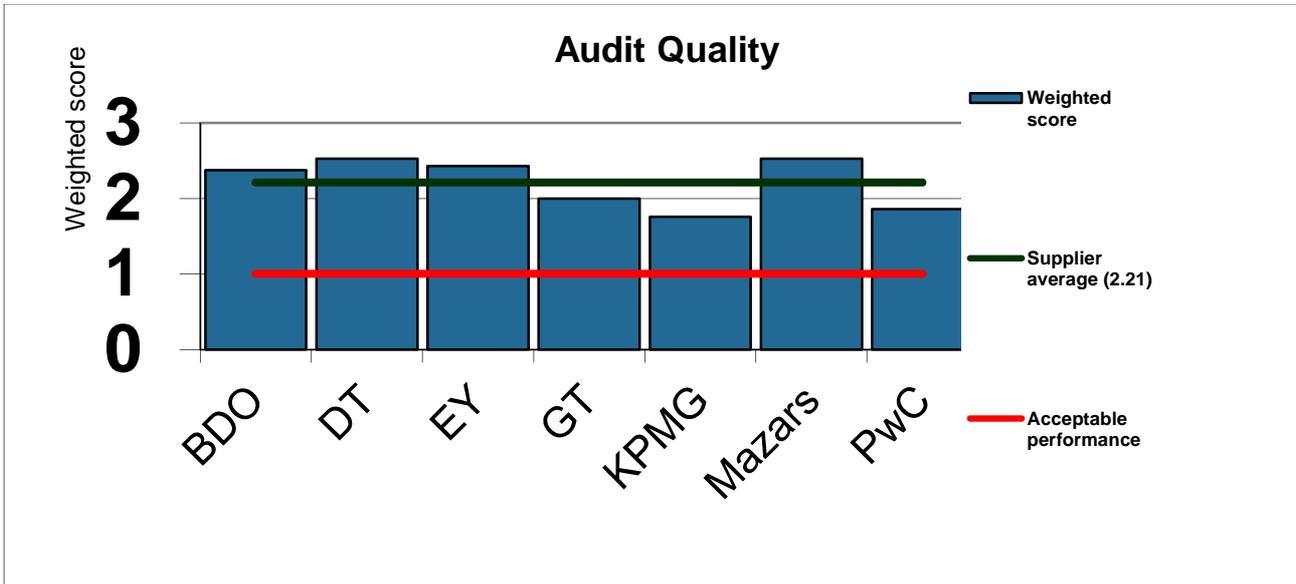
18 EY's score was 2.43, compared to an all firm average of 2.21. This was a slight reduction on last year's score of 2.55, although this year we used a slightly amended scoring base<sup>1</sup>.

19 Figure 2 shows the assessment of EY's overall audit quality performance in comparison to other firms.

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<sup>1</sup> The prior year assessment included consideration of Whole of Government Accounts work which is not included in the current year assessment. The current year assessment gives a higher weighting to financial statements work.

Figure 2: 2016 Audit quality performance



20 Our QRP methodology is designed to highlight any specific weaknesses at individual file level, specifically where our benchmark score of 1 is not met, which may have ordinarily been masked behind a high average score across the various elements (Financial statements, VFM and HB COUNT) of the QRP.

21 We have calculated a red, amber, green (RAG) indicator for each element of the QRP, using the principles detailed in Appendix 2, as well as for overall audit quality. Where a firm scores an average of less than 2, or has any scores of 0, a rating higher than amber in that element is not possible.

22 For 2015/16, EY’s overall rating for audit quality was green. We consider each of the individual elements making up this rating below.

Figure 3: 2016 Comparative performance for audit quality



**Financial statements audit work**

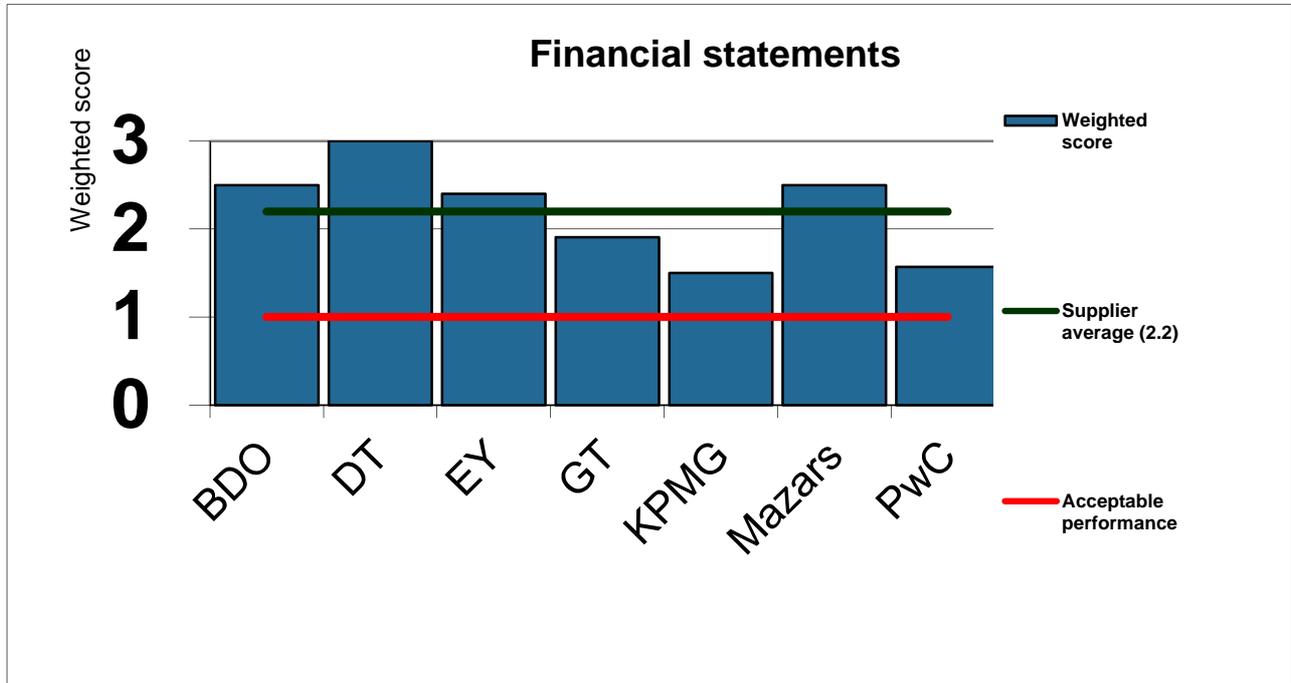
23 The firm provided the results of eight QMRs for financial statement audit files. We reviewed these and agreed with all the firm assessments with one exception where we felt a score of 2 was more appropriate than a score of 3. In addition, the AQR review for PSAAs provided a score for two additional financial statements assessments.

24 The improvement areas from these individual QMRs and the AQR review included:

- ensuring clearer evidence on the file over the appropriateness of work done by the valuer on major asset holdings;
- ensuring there is sufficient evidence on file to support the valuation of pension assets.

25 Figure 4 shows the comparative performance for financial statement audit work based on the results of the QMRs and AQR review. EY's average score was 2.4 compared to an all firm average of 2.2.

Figure 4: 2016 financial statements performance



26 For 2014/15, EY's rating for financial statements work was green.

Figure 5: 2015 Comparative performance for financial statements audit work



**VFM conclusion audit work**

27 The firm provided the results of five QMRs for VFM conclusion audit files. We reviewed the results and agreed with the assessments.

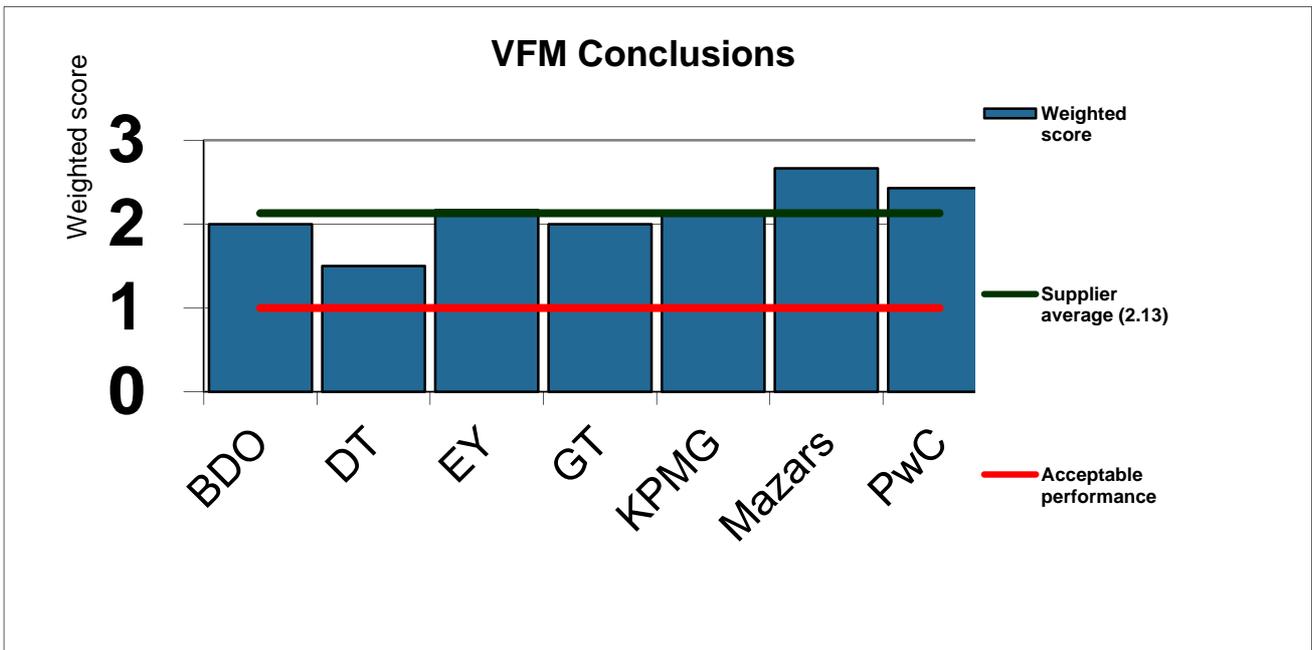
28 In addition, the AQR review for PSAA provided a score for one additional VFM conclusion assessment.

29 The improvement areas from these individual QMRs and the AQR review included:

- ensuring better evidencing of timely review of work by the engagement lead; and
- ensuring clearer documentation on file on the consideration of risks.

30 Figure 6 shows the comparative performance for VFM audit work based on the results of the QMRs and AQR review. EY's score was 2.17 compared to an all firm average of 2.13.

Figure 6: 2016 VFM conclusion performance



31 For 2014/15, EY's rating was green on VFM conclusion work.

Figure 7: 2015 Comparative performance for VFM conclusion audit work



### Housing benefit work

32 Each year auditors certify local authority claims for housing benefit subsidy to the Department for Work and Pensions (DWP). They are required to undertake this work using specific guidance and tools (HB COUNT) which are agreed annually with the DWP. HB COUNT sets out the approach and work needed to certify the subsidy claim form. It 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.

33 The firm provided the results of five QMRs for HB COUNT audit work. We reviewed the results of these and we agreed with all of the firm's assessments.

34 The improvement areas from these individual QMRs included:

- ensuring compliance with the certification instructions on housing benefit work, particularly around mapping and evidencing conclusions against the specific test requirements;
- ensuring that any amendments made to the claim relate to isolated errors only.

35 Figure 8 shows the comparative performance of each firm based on the QMRs. EY's average score was 2.8 compared to an all firm average of 2.48.

Figure 8: 2016 HB COUNT performance



36 For 2014/15, EY's rating was green for HB COUNT audit work.

Figure 9: 2015 Comparative performance for HB COUNT audit work

BDO	DT	EY	GT	KPMG	Mazars	PwC
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## Regulatory compliance

### Systems for compliance with our regulatory requirements

37 In 2015/16, EY confirmed to PSAA that its systems and procedures for regulatory compliance were the same as those in the previous year. Nothing came to PSAA's attention in year to suggest this is not correct, and we concluded that it could continue to rely on EY's systems.

### Systems for compliance with our information assurance requirements

38 During 2015, PSAA instructed its Internal Auditor (TIAA) to undertake a review of the firm's information assurance arrangements based on a return completed by the firm. The review considered whether the firm met the requirements of information governance legislation. There were no issues arising as a result of this review and we concluded that we could continue to rely on the firm's arrangements.

### Quarterly monitoring of our regulatory requirements

39 PSAA reported the details in the quarterly monitoring reports issued to the firm during the year, including fee variation request and requests for non-audit services from the firm. Figure 10 details the firm's overall regulatory compliance RAG rating compared to other firms.

Figure 10: 2016 Comparative performance for regulatory compliance

BDO	DT	EY	GT	KPMG	Mazars	PwC
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40 The firm performed well across all of the regulatory compliance requirements, with all but two of the 15 indicators being rated as green.

41 We have included a summary at Appendix 3 of the results of the 2015/16 regulatory compliance monitoring RAG ratings, comparing the firm's performance against the overall performance for all firms.

## Client satisfaction surveys

42 All firms agreed to undertake client satisfaction surveys for 2014/15 audits, and to report the results to PSAA. We specified questions to be included in the survey and asked firms to provide us with an analysis of the results.

43 The firm received results from a sample of audited bodies on completion of their 2014/15 audit. Table 1 details the questions and the average score.

**Table 2- Satisfaction survey results**

Question	Average score (max. 10)*
How satisfied are you overall with your audit?	8.8
How satisfied are you with the amount of contact with your Engagement Lead?	8.7
How satisfied are you with the amount of contact with your Audit Manager?	9.0
How satisfied are you with the technical competence and skills of your audit team?	8.2
How satisfied are you with your auditor's performance at committee meetings?	9.1
How satisfied are you with your auditor's understanding of the key issues and risks specific to your organisation?	8.8
How satisfied are you with the usefulness of your auditor's reports?	8.8
How satisfied are you with the timeliness of your auditor's reports?	8.5

44 These results show that audited bodies are satisfied with the level of service received from EY and for 2015/16, EY's rating for client satisfaction was green.

**Figure 11: 2016 Comparative performance for client satisfaction**

BDO	DT	EY	GT	KPMG	Mazars	PwC
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45 The firm has undertaken an analysis of any improvements points raised in the survey and has committed to action any individual improvement points identified.

## Recommendations

### Recommendations arising from the 2015/16 quality review programme

**46** The key areas for improvement identified this year from file reviews are noted below, as taken from the body of this report:

#### *Financial statements*

- ensuring clearer evidence on the file over the appropriateness of work done by the valuer on major asset holdings;
- ensuring there is sufficient evidence on file to support the valuation of pension assets.

#### *VFM*

- ensuring better evidencing of timely review of work by the engagement lead;
- ensuring clearer documentation on file on the consideration of risks.

#### *HB*

- ensuring compliance with the certification instructions on housing benefit work, particularly around mapping and evidencing conclusions against the specific test requirements; and
- ensuring that any amendments made to the claim relate to isolated errors only.

**47** Appendix 4 provides details of the actions the firm has, or intends to take to address these improvement areas. We understand the findings from the QMR will be considered by the firm's quality team and then communicated to staff.

## Appendix 1 – Weightings to calculate overall quality score

Table 3- weightings

<b>Audit element</b>	<b>Local government</b>	<b>NHS</b>
	<b>%</b>	<b>%</b>
Financial statements	60	70
VFM Conclusions	30	30
HB	10	-
Total	100	100

## Appendix 2 - Audit quality and regulatory compliance RAG rating

Table 4- QRP elements of financial statements, VFM conclusions and housing benefit work.

Rating	Firm level: Overall Audit Quality score	Firm level: Individual QRP element
<b>Green</b>	Firm audit quality score $\geq 2$ and no scores of '0' at file review level	Average element score $\geq 2$ and no scores of '0' at file review level
<b>Amber</b>	Firm audit quality score $\geq 1$ with up to two scores of '0' at file review level	Average element score $\geq 1$ with up to one score of '0' at file review level
<b>Red</b>	Firm audit quality score $< 1$ , <b>or</b> Firm audit quality score $\geq 1$ but three or more scores of '0' at file review level	Average element score $< 1$ , <b>or</b> Average element score $\geq 1$ but two or more scores of '0' at file review level

Table 5- Regulatory compliance RAG rating based on 15 quarterly monitoring indicators

Rating	Overall firm level score- indicators
<b>Green</b>	11 or more at green and no more than two at red.
<b>Red</b>	Six or more indicators at red.
<b>Amber</b>	Neither green nor red.

Table 6- Combined audit quality and regulatory compliance RAG

		QRP RAG		
		Red	Amber	Green
Regulatory compliance RAG	Red	R	R	A
	Amber	R	A	A
	Green	A	A	G

**Table 7- RAG rating the results of satisfaction survey results**

<b>Firm 0-10 assessment (average)</b>	<b>Firm unsatisfactory – satisfactory assessment (average)</b>	<b>PSAA RAG rating</b>
0-3	very dissatisfied / dissatisfied / unsatisfactory	R
4-6	reasonable / good / satisfied	A
7-10	very good / very satisfied / outstanding	G

## Appendix 3 - Results of 2015/16 regulatory compliance monitoring

Activity	Target	All firms % (no).	EY % (no).	Red, amber, green (RAG) status
Issue of planning letters.	100% by 30 April 2015.	100	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Issue of NHS audit opinions.	100% by 29 May 2015 (CCG) and 5 June 2015 (NHS Trusts).	97.7 (7)	90.5 (4)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Issue of NHS VFM conclusions.	100% by 29 May 2015 (CCG) and 5 June 2015 (NHS Trusts).	98.0 (6)	90.5 (4)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Confirmation of final fee to NHS audited bodies.	100% by 31 July 2015.	99.7 (1)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Issue of NHS annual audit letters.	100% by 31 July 2015.	98.7 (4)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Issue of LG audit opinions.	100% by 30 September 2015.	97.1 (15)	97.1 (3)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Issue of LG VFM conclusions.	100% by 30 September 2015.	97.1 (15)	97.1 (3)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Issue of WGA reports.	100% issued by 2 October 2015.	94.7 (27)	97.1 (3)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.

Activity	Target	All firms % (no).	EY % (no).	Red, amber, green (RAG) status
Confirmation of final LG fee to audited body.	100% by 30 October 2015.	96.7 (17)	99.0 (1)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Issue of LG annual audit letters.	100% by 30 October 2015.	97.5 (13)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Audited body database information.	Accurate information provided to PSAA.	98.9 (15)	99.2 (2)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Complaints upheld against auditors.	No complaints upheld against auditors.	0	0	G = 0 upheld A = 1 R = 2 or more
Non-compliance with requirements on independence issues.	No instances of non-compliance.	2	0	Firm G = up to 1 A = 2 R = 3 or more  Regime G = up to 7 A = 8 R = 9 or more.
Objections decided upon within nine months.	100% of objections decided upon within nine months.	14	0	Firm G = up to 1 A = 2 R = 3 or more  Regime G = up to 7 A = 8 R = 9 or more.
Attendance at Contact Partner group meetings.	No meetings missed.	0	0	Firm G = up to 2 A = 3 R = 4 or more  Regime G = up to 7

Activity	Target	All firms % (no).	EY % (no).	Red, amber, green (RAG) status
				A = 8 R = 9 or more.

## Appendix 4 - Summary of regulatory compliance and QRP improvement areas

Table 8- improvement areas

Area	Improvement required	Firm response
Key messages from FRC annual reports	<p>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;</p> <p>A need for some improvement in the sufficiency and appropriateness of audit procedures being performed on revenue recognition; and</p> <p>A need to report more thoroughly to audit committees.</p>	The firm will address these points, to the extent that they are relevant, as part of its response to the FRC.
AQR review on PSAA work (across all firms)	<p>Clearly justify and document materiality considerations and not default automatically to the top of the materiality range;</p> <p>Consider property valuations as significant risk areas, and ensure that when considering external valuers' work there is review and challenge of management assumptions. In addition, audit teams need to verify the completeness and accuracy of source data used by experts and evidence that assets are revalued on the appropriate cycle in accordance with accounting policies;</p> <p>Evidence journals selected for testing by audit teams, while improving procedures to ensure the completeness of the population of journals considered for testing;</p>	<ul style="list-style-type: none"> <li>• EY policy for GPS is that materiality levels above 1% have to be approved by PPD. As part of this process justification of the basis for any increase above 1% has to be provided and this is documented on audit files</li> <li>• Consideration of the issues noted related to property valuations and journals has been covered in training on quality and efficiency that has been provided to all teams in March and April 2016 as part of the annual programme of quality and technical training. Course material can be made available on request.</li> <li>• Updated documentation on the approach to gaining assurance over the material accuracy of pension asset valuations and actuarial assumptions has been produced and will be shared with all audit teams. This documentation will start to be used from the 31 March 2016 year end local government audit cycle.</li> </ul>

	<p>Better evidence work on asset valuations and ensure actuarial assumptions are appropriately challenged; and</p> <p>Ensure that VFM work covers financial resilience over an appropriate period and that the outcomes from VFM work are reporting in sufficient detail to those charged with governance.</p>	<ul style="list-style-type: none"> <li>• Training has been provided to audit teams on the new NAO guidance for value for money. Further guidance on the period to be considered in assessing arrangements to deploy resources in a sustainable manner and reporting the outcomes from VFM to those charged with governance has also been provided to teams. Our reporting templates have also been updated to encourage enhanced reporting.</li> </ul>
Financial statements	<p>Ensuring clearer evidence on the file over the appropriateness of work done by the valuer on major asset holdings; and</p> <p>Ensuring there is sufficient evidence on file to support the valuation of pension assets.</p>	See above response to AQR review across all Firms
VFM conclusions	<p>Ensuring better evidencing of timely review of work by the engagement lead; and</p> <p>Ensuring clearer documentation on file on the consideration of risks.</p>	<ul style="list-style-type: none"> <li>• Engagement leads will be reminded of the need to review VFM work on a timely basis</li> <li>• The issues noted related to the consideration of risk for the value for money conclusion have been covered in training on quality and efficiency that was provided to all teams in March and April 2016 as part of the annual programme of quality and technical training. The templates used to document the VFM risk assessment have also been updated for 2015/16.</li> </ul>
Housing benefit	<p>Ensuring compliance with the certification instructions on housing benefit work, particularly around mapping and evidencing conclusions against the specific test requirements; and</p>	<ul style="list-style-type: none"> <li>• Training has been provided for those new to HB, new to the team leader (TL) role and new managers/ directors which covered the CI requirements and documentation of certification work</li> <li>• A HB QUIP has been developed and shared with teams via the GPS Quality &amp; Efficiency e-mail. This covers the</li> </ul>

	Ensuring that any amendments made to the claim relate to isolated errors only.	specific points identified from the internal AQR reviews of individual HB file reviews. <ul style="list-style-type: none"><li>• The training for those new to TL and new managers / directors has covered the requirements in relation to claim amendments and reporting</li></ul>
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