

# Regulatory Compliance and Quality Review Programme

**Annual Report 2016**

**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 2014/15; and
  - regulatory compliance- reporting quarterly on audit firms' compliance with our 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) conclusions 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 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 15 key indicators relating to Terms of Appointment requirements;
  - a review of each firms' systems to ensure they comply with our regulatory requirements; and
  - a review of each firm's client satisfaction surveys for 2014/15 work.
- 4 In the limited assurance regime, the measurements and checks comprise:
  - the results of firms' compliance with five key indicators relating to Terms 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 2014/15 work.

5 This report summarises the results of the quality review process for 2016.

## Overall performance

6 In our principal and limited assurance regimes, 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; 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
BDO	Grant Thornton	
Deloitte	KPMG	
EY	PwC	
Mazars		

9 In the limited assurance regime, we assess the overall quality of 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 quality performance for each limited assurance firm is detailed in Table 2<sup>1</sup>.

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

**Table 2: Quality performance scores**

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

- 11** The results of the monitoring programme show that quality has improved 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 15 key indicators. These include the target dates for issuing audit opinions on the financial statements and VFM conclusions; 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 (97.7 per cent for NHS and 97.1 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 2014/15 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 reports published on 19 May 2016 show that in overall terms the quality of statutory audit regulated by the FRC is improving.

**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 on revenue recognition; and
- a need to report more thoroughly to audit committees.

**21** The results of the FRC reviews on a sample of 15 PSAA engagements for 2014/15 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.

### *Value for money conclusions*

**23** Auditors are required 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.

**24** 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*

**25** 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.

**26** 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

**27** 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 but in a small number of cases there is still 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 work

- 28** 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.
- 29** This work leads to the issue of a limited assurance audit opinion on the annual return and a certificate of closure.
- 30** We undertook our own reviews of a sample of limited assurance work at each firm, in addition to relying on firms' internal arrangements.
- 31** 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.
- 32** 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.
- 33** Auditors met the majority of our target dates for issuing the limited assurance opinion (99 per cent overall). In addition the results of satisfaction surveys issued by firms for 2014/15 audit work showed that audited bodies were satisfied with their auditor.

## QRP results- limited assurance work

### *Limited assurance work*

- 34 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.
- 35 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.
- 36 There were no systematic concerns about the overall quality of limited assurance audit work.

## **Responses to QRP findings and next year's QRP**

**37** 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.

**38** We intend to continue with our regulatory compliance reports for all suppliers. Where required, we will make visits to firms.

**39** Our programme for next year will continue to include reviews of audit work by the FRC; and reliance on the results of firms' QMRs.

**40** 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.