

# Annual Regulatory Compliance and Quality Report

**BDO LLP**

**July 2017**

**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 a number of statutory functions (from the Audit Commission Act 1998) to PSAA on a transitional basis by way of a letter of delegation issued under powers contained in the Local Audit and Accountability Act 2014.**

**As a consequence of these delegations, for 2017/18 the company will continue to be responsible under transitional arrangements for appointing auditors to local government and police bodies, for setting audit fees and for making arrangements for certification of housing benefit subsidy claims.**

**Looking beyond 2017/18, the Secretary of State has specified PSAA as an appointing person for principal local government bodies from 2018/19, under the provisions of the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2016**

## Contents

|   |    |
|---|----|
| Summary report .....  | 4  |
| <b>Introduction</b> .....   | 4  |
| <b>Overall performance</b> .....  | 5  |
| Detailed report .....   | 6  |
| <b>Quality review programme</b> .....   | 6  |
| <b>Regulatory compliance</b> .....  | 12 |
| <b>Recommendations</b> .....  | 14 |
| Appendix 1 – Weightings to calculate overall quality score.....               | 16 |
| Appendix 2 - Audit quality and regulatory compliance RAG rating.....          | 17 |
| Appendix 3 - Results of 2016/17 regulatory compliance monitoring .....        | 19 |
| Appendix 4 - Summary of regulatory compliance and QRP improvement areas ..... | 21 |

# 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 2015/16 year of account; and
  - regulatory compliance- reporting quarterly on audit firms' compliance with our 2016/17 regulatory requirements as set out in the Terms of Appointment.
- 3 The audit quality and regulatory compliance monitoring for 2016/17 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 internal quality monitoring reviews (QMRs) of its financial statements, Value for Money (VFM) arrangements 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 firms 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 2015/16 work.
- 4 This report summarises the results of our monitoring work for BDO 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.

6 For 2016/17, BDO's combined audit quality and regulatory compliance rating was amber.

---

Figure 1: 2017 Comparative performance for audit quality and regulatory compliance

|     |    |    |      |        |
|-----|----|----|------|--------|
| BDO | EY | GT | KPMG | Mazars |
|-----|----|----|------|--------|

7 BDO's overall weighted audit quality score has decreased to 1.62 from 2.38 last year.

8 BDO maintained its green rating performance against the regulatory compliance indicators since last year, with eleven indicators scored as green, two as amber and two as red.

9 The satisfaction survey results show that audited bodies are very satisfied with the performance of BDO as their auditor.

## Detailed report

### Quality review programme

#### *FRC Inspection*

**10** Every year each firm provides a self-assessment in the form of a transparency report issued in accordance with the requirements of the Professional Oversight Board of the FRC. Our review of the latest BDO transparency report did not highlight any significant issues of note.

**11** 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. The reports focus on the key areas requiring action by the firm to safeguard and enhance audit quality. They do not seek to provide a balanced scorecard of the quality of a firm's audit work.

**12** In its latest public report on BDO, the FRC reported on eight engagement reviews. In seven cases they concluded that audit procedures were performed to an acceptable standard. One audit was identified as requiring significant improvement, one more than last year.

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

- challenge of management in key areas involving judgement, such as impairment reviews, asset valuations and provisions;
- the design and execution of audit procedures relating to revenue recognition; and
- systems and arrangements for ensuring compliance with ethical and independence requirements.

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

**15** We also commissioned inspections of all firms by the FRC's Audit Quality Review Team (AQRT) for this year's QRP. The AQRT inspected one financial statements opinion and one VFM arrangements conclusion file from BDO's 2015/16 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 AQRT, we assessed the financial statements audit as significant improvements required. The VFM arrangements conclusion work was also assessed as significant improvements required.

**16** The principal issues resulting from the AQRT reviews of financial statement audits, across all the firms, following this year's programme of work for PSAA were:

- insufficient challenge and independent corroboration of management experts' valuations of property, plant and equipment (PPE) and other fixed assets;
- insufficient documentation of risk assessment procedures where PPE not classified as a significant audit risk despite the account balance being subject to key estimation

uncertainty and valuation policies requiring periodic valuations increasing the risk of misstatement over the account balance;

- insufficient audit work over the valuation of pension scheme assets, testing of data provided to actuaries and direction and review of the pension fund auditor;
- inadequate procedures to test the completeness, authorisation and appropriateness of journals, and risk characteristic testing not comprehensive in all cases;
- deficiencies in the audit procedures of a first year audit, including lack of consideration of prior year significant risks and issues as part of the audit team's risk assessment, and insufficient evidence of client take on procedures;
- limited evidence to support the testing rationale for operating expenditure and the testing of completeness of expenditure and liabilities; and
- the involvement of the RI in the areas of key audit significance was not to the level expected and was a potential causal factor for many of the issues identified in at the audits for which they were responsible.

**17** In respect of VFM arrangements work, the AQRT reported:

- a lack of enquiry of senior and non-financial management staff as part of the audit team's risk assessment;
- where risks were identified, there was a lack of inquiry of appropriate management in completing procedures in response to those identified significant risks; and
- failure to evidence account taken of governance issues (e.g. changes to s151 officer, political leadership, matters in reported in Annual Governance Statement).

**18** We have combined our scores for the AQRT 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*

**19** 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 2016/17 we relied on each firm's own quality monitoring arrangements.

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

**21** 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.

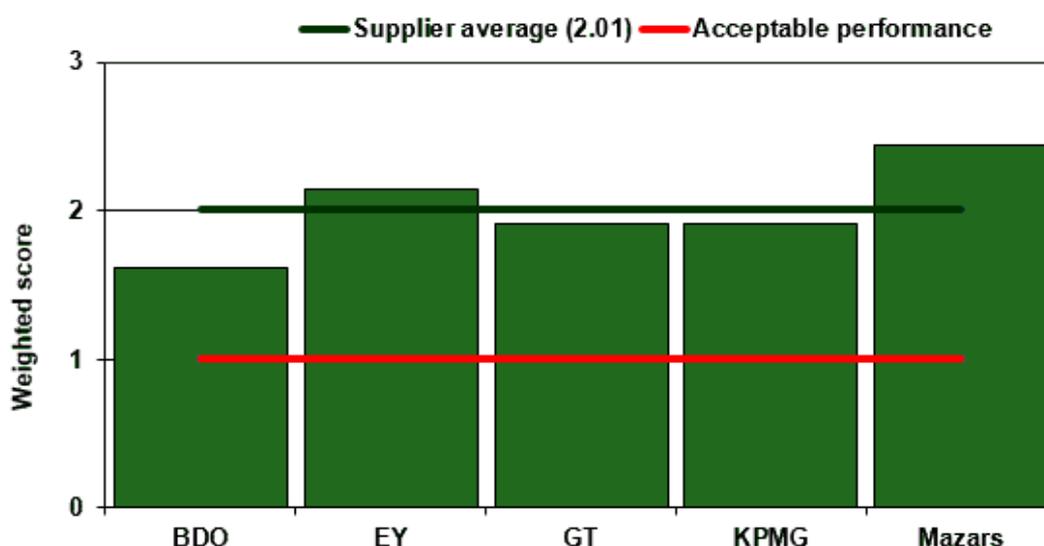
Table 1: PSAA assessment scale

| Score | Descriptor                                    |
|-------|---|
| 3     | Good  |
| 2     | Acceptable with limited improvements required |
| 1     | Acceptable overall with improvements required |
| 0     | Significant improvements required             |

22 BDO's score was 1.62, compared to an all firm average of 2.01. This was lower than last year's score of 2.38.

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

Figure 2: 2017 Audit quality performance



24 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.

25 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. Where a firm has three individual scores of 0, then the overall rating is red.

26 For 2016/17, BDO's overall rating for audit quality was red as it had four audit quality scores of 0. We consider each of the individual elements making up this rating below.

---

Figure 3: 2017 Comparative performance for audit quality



### Financial statements audit work

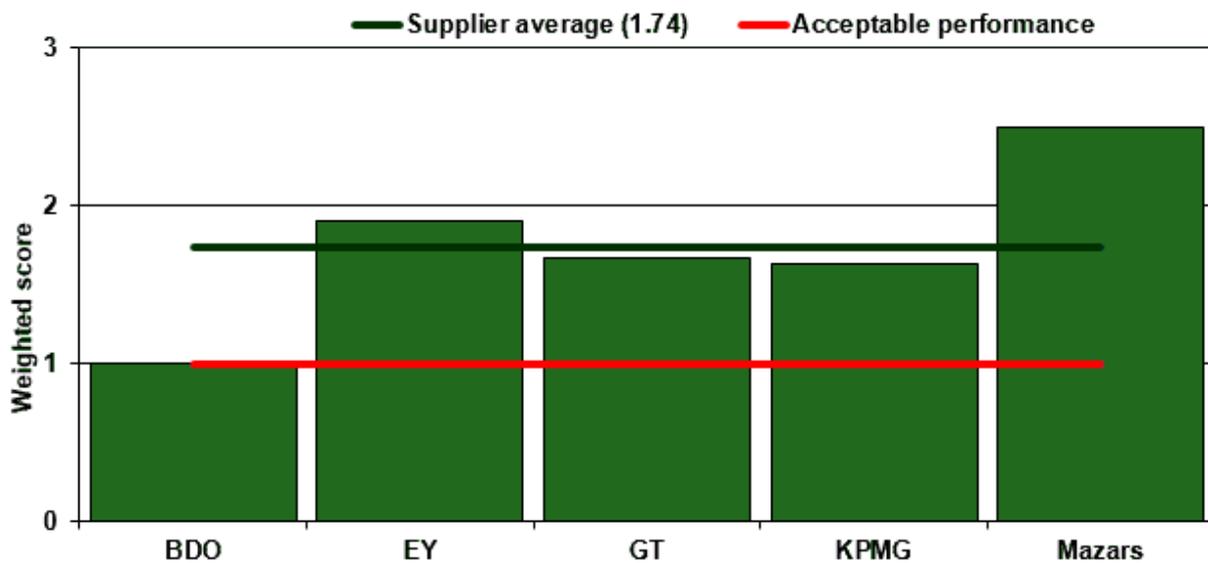
The firm provided the results of four QMRs for financial statement audit files. We reviewed these and agreed with the firm's assessments.

27 The improvement areas from these reviews included:

- obtaining better evidence to support asset valuations;
- better documenting audit sampling, journals testing and the validity of information prepared by the entity; and
- having clearer documentation on file of Engagement Quality Control Reviewer involvement.

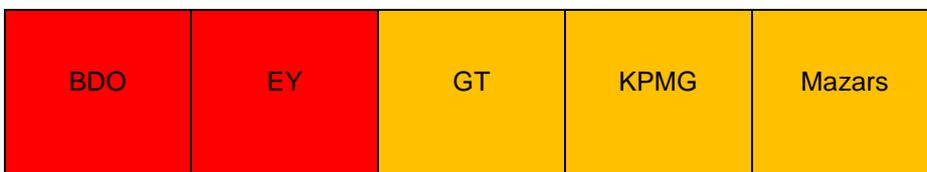
28 In addition, the AQRT reviews for PSAA provided a score for one additional financial statements assessment. Figure 4 shows the comparative performance for financial statement audit work based on the results of the QMRs and AQR review. BDO's average score was 1.0 compared to an all firm average of 1.74.

Figure 4: 2017 financial statements performance



29 For 2015/16 audit work, BDO's rating for financial statements work was rated red because two financial statement audits were scores as 0 (significant improvements required).

Figure 5: 2017 Comparative performance for financial statements audit work



### VFM conclusion audit work

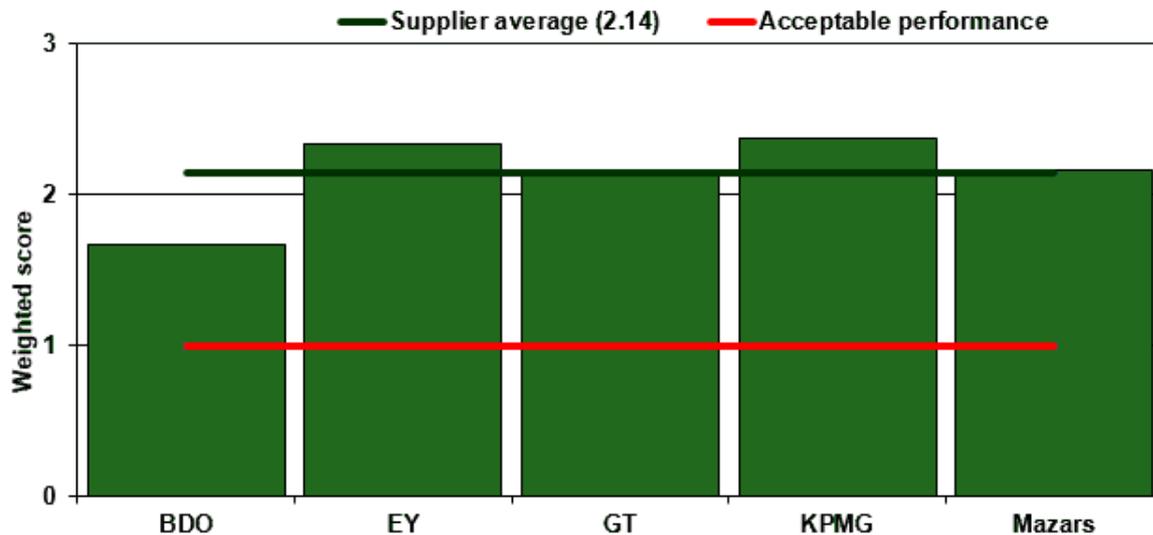
30 The firm provided the results of two QMRs for VFM arrangements conclusion audit work. We reviewed the results and agreed with the assessments.

31 The improvement areas from these individual QMRs and the AQRT review included:

- ensuring information from different sources is triangulated; and
- ensuring clearer documentation on file of the consideration of risks and evidence.

32 In addition, the AQR review for PSAA provided a score for one additional VFM arrangements conclusion assessment. Figure 6 shows the comparative performance for VFM audit work based on the results of the QMRs and the AQRT review. BDO's score was 1.67 compared to an all firm average of 2.14.

Figure 6: 2017 VFM conclusion performance



33 For 2015/16 VFM arrangements conclusion work, BDO’s rating was amber as one VFM arrangements conclusion was rated as 0 (significant improvements required).

Figure 7: 2017 Comparative performance for VFM conclusion audit work



**Housing benefit work**

34 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.

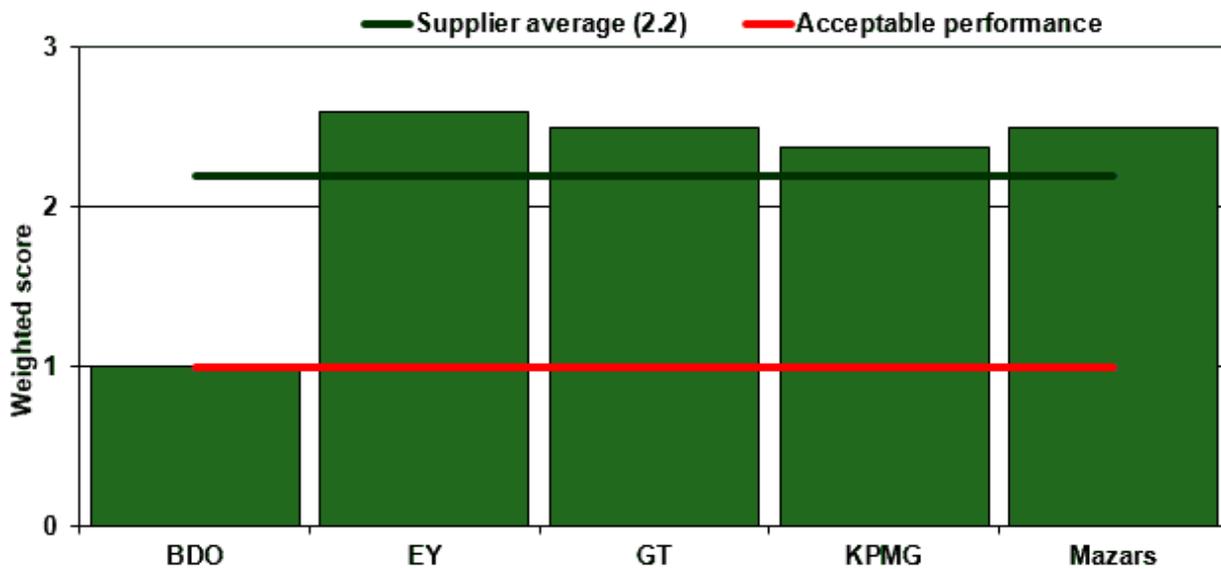
35 The BDO provided the results of two QMRs for HB COUNT work. We reviewed the results of these and we agreed with the BDO’s assessments.

36 The improvement areas from these individual QMRs included:

- ensuring any qualification letter points contain the level of detail required by the Certification Instructions, completing extended testing where required;
- fully completing and retaining the HB COUNT workbooks.

37 Figure 8 shows the comparative performance of each firm based on the QMRs. BDO's average score was 1.00 compared to an all firm average of 2.20.

Figure 8: 2017 HB COUNT performance



38 For 2016/17, HB Count certification work BDO's rating was amber as one HB COUNT piece of work was rated as 0 (significant improvements required).

Figure 9: 2017 Comparative performance for HB COUNT audit work



### Regulatory compliance

#### Systems for compliance with our regulatory requirements

39 In 2016/17, BDO 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 we could continue to rely on BDO's systems.

#### Systems for compliance with our information assurance requirements

40 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 BDO. 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 rely on the firm's arrangements. For this review, the firm has provided confirmation that its general systems and procedures have not changed and we can continue to rely on them for regulatory compliance

### Quarterly monitoring of our regulatory requirements

41 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: **2017 Comparative performance for regulatory compliance**

|     |    |    |      |        |
|-----|----|----|------|--------|
| BDO | EY | GT | KPMG | Mazars |
|-----|----|----|------|--------|

42 The firm generally performed well across eleven of the regulatory compliance requirements. There were three authorities where the firm was unable to issue its opinions in line with the target date. This also had an effect on other indicators, so four of the 15 indicators were not rated as green:

- issue of LG opinions (red);
- issue of LG VFM arrangements conclusions (red);
- issue of WGA reports (amber); and
- issue of AALs (amber).

43 We have included a summary at Appendix 3 of the results of the 2016/17 regulatory compliance monitoring RAG ratings, comparing the firm's performance against the overall performance for all firms.

### Client satisfaction surveys

44 All firms agreed to undertake client satisfaction surveys for 2015/16 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.

45 The firm received results from a sample of audited bodies on completion of their 2015/16 audit. Table 2 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?   | 8.0                     |
| How satisfied are you with the amount of contact with your Engagement Lead?  | 8.2                     |
| How satisfied are you with the amount of contact with your Audit Manager?  | 8.2                     |
| How satisfied are you with the technical competence and skills of your audit team?                                 | 7.7                     |
| How satisfied are you with your auditor's performance at committee meetings?                                       | 7.8                     |
| How satisfied are you with your auditor's understanding of the key issues and risks specific to your organisation? | 8.3                     |
| How satisfied are you with the usefulness of your auditor's reports?   | 7.5                     |
| How satisfied are you with the timeliness of your auditor's reports?   | 7.5                     |

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

Figure 11: **2017 Comparative performance for client satisfaction**

|     |    |    |      |        |
|-----|----|----|------|--------|
| BDO | EY | GT | KPMG | Mazars |
|-----|----|----|------|--------|

46 The firm has undertaken an analysis of any improvement points raised in the survey and has committed to action any individual improvement points identified.

### Recommendations

#### Recommendations arising from the 2016/17 quality review programme

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

### *Financial statements*

- obtaining better evidence to support asset valuations;
- better documenting audit sampling, journals testing and the validity of information prepared by the entity; and
- having clearer documentation on file of Engagement Quality Control Reviewer involvement.

### *VFM*

- ensuring information from different sources is triangulated; and
- ensuring clearer documentation on file of the consideration of risks and evidence.

### *HB*

- ensuring any qualification letter points contain the level of detail required by the Certification Instructions, completing extended testing where required; and
- fully completing the HB COUNT workbooks.

### *Compliance*

- No issues

**48** 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<br/>60%</b> | <b>NHS<br/>40%</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

| 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

| Firm assessment (average)<br>0 – 5<br>0 - 10 | Firm<br>unsatisfactory –<br>satisfactory assessment<br>(average) | PSAA RAG rating |
|--|--|-----------------|
| 0-1.5<br>0 - 3                               | very dissatisfied /<br>dissatisfied / unsatisfactory             | R               |
| 1.5 – 3.5<br>4 – 6                           | reasonable / good /<br>satisfied                                 | A               |
| 3.5 – 5<br>7 - 10                            | very good / very satisfied /<br>outstanding                      | G               |

### Appendix 3 - Results of 2016/17 regulatory compliance monitoring

| Activity   | Target  | All Suppliers<br>%<br>(no.) | BDO<br>%<br>(no.) | Firm<br>Comments   |
|--|---|-----------------------------|-------------------|--|
| Issue of planning (fee) letters.                             | 100% by 29 April 2016.<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed                                  | 100%<br>(0)                 | 100%<br>(0)       |  |
| Issue of NHS audit opinions.                                 | 100% by 27 May 2016 (CCG) and 1 June 2016 (NHS Trusts).<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed | 100%<br>(0)                 | 100%<br>(0)       |  |
| Issue of NHS VFM conclusions.                                | 100% by 27 May 2016 (CCG) and 2 June 2016 (NHS Trusts).<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed | 100%<br>(0)                 | 100%<br>(0)       |  |
| Issue of local government audit opinions.                    | 100% by 30 September 2016.<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed                              | 97%<br>(16)                 | 86%<br>(3)        | These opinions were delayed due to circumstances beyond the firm's control.                                    |
| Issue of local government audit VFM conclusions.             | 100% by 30 September 2016.<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed                              | 97%<br>(17)                 | 86%<br>(3)        | These VFM arrangements opinions were delayed due to circumstances beyond the firm's control.                   |
| Issue of WGA reports.  | 100% by 21 October 2016.<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed                                | 97%<br>(16)                 | 91%<br>(2)        | These were issued after the target date as a result of the delays in issuing the financial statements opinion. |
| Confirmation of final NHS fee to audited bodies              | 100% by 31 July 2016<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed                                    | 100%<br>(0)                 | 100%<br>(0)       |  |
| Issue of NHS annual audit letters.                           | 100% by 31 July 2016<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed                                    | 99%<br>(2)                  | 100%<br>(0)       |  |
| Confirmation of final local government fee to audited bodies | 100% by 30 October 2016<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed                                 | 100%<br>(0)                 | 100%<br>(0)       |  |
| Issue of local government annual audit letters.              | 100% by 30 October 2016<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed                                 | 97%<br>(18)                 | 91%<br>(2)        | These were issued after the target date as a result of the delays in issuing the financial statements opinion. |

| Activity   | Target  | All Suppliers<br>%<br>(no.) | BDO<br>%<br>(no.) | Firm<br>Comments |
|--|---|-----------------------------|-------------------|------------------|
| Audited body database information.                       | Accurate database information provided to PSAA.<br><br>Green>95.01% delivered or only 1 missed<br>Amber 90.01% to 95% delivered or only 2 missed<br>Red<90% delivered or 3 or more missed                 | 99%<br>(11)                 | 100%<br>(0)       |                  |
| Complaints upheld against auditors.                      | Complaints upheld against auditors.<br><br>Green 0 Upheld<br>Amber 1 upheld<br>Red 2 or more upheld   | 1                           | 0                 |                  |
| Non-compliance with requirements on independence issues. | Instances of non-compliance.<br><br>Firms: Green 1 case<br>Amber 2 cases<br>Red 3 or more cases<br><br>Regime: Green Up to 5 cases<br>Amber 6 or 7 cases<br>Red 8 or more cases                           | 1                           | 0                 |                  |
| Attendance at Contact Partner Meetings                   | Attendance of Contact Partner at all meetings.<br><br>Firms: Green 1 case<br>Amber 2 cases<br>Red 3 or more cases<br><br>Regime: Green Up to 5 cases<br>Amber 6 or 7 cases<br>Red 8 or more cases         | 0                           | 0                 |                  |
| Consideration of objections                              | Outstanding objections not determined within 9 months.<br><br>Firms: Green 1 case<br>Amber 2 cases<br>Red 3 or more cases<br><br>Regime: Green Up to 5 cases<br>Amber 6 or 7 cases<br>Red 8 or more cases | 5                           | 0                 |                  |

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

Table 8- improvement areas

| Area                                 | Improvement required   | BDO response  |
|--------------------------------------|--|---|
| Key messages from FRC annual reports | <p>A need for auditors to improve the quality of the audit evidence of the challenge of management on key judgement areas, such as impairment reviews, asset valuations and provisions;</p> <p>A need for auditors to improve the design and execution of audit procedures relating to revenue recognition; and</p> <p>A need for auditors to improve the systems and arrangements for ensuring compliance with ethical and independence requirements.</p> | <p><b>Quality and Documentation of Audit Evidence</b></p> <p>The quality and documentation of audit evidence particularly in key judgement areas were identified in a number of root cause analysis investigations undertaken as a result of the files reviewed by the FRC in 2016.</p> <p>A number of actions have been undertaken to address this issue:</p> <p><b><u>ISA 540 workbook</u></b></p> <p>We have created a new ISA 540 workbook which was released in March 2017 to be used when dealing with significant audit estimates. This should ensure that we make appropriate assessments of the work of the expert, provide sufficient challenge to management about key judgements and document clearly the results of our testing made in relation to fair values and the sensitivities around these judgements.</p> <p><b><u>Training</u></b></p> <p>The firm has created mandatory training for the new ISAs (UK) which is being rolled out to the</p> |

|  |  |   |
|--|--|---|
|  |  | <p>audit stream in summer/autumn 2017. The key messages are:</p> <ul style="list-style-type: none"> <li>• Understand the principles documented in the ISAs (UK)</li> <li>• Decide how these should be practically applied to the audit including what audit evidence is required; and</li> <li>• Document clearly the work performed in the audit tool including all relevant audit evidence.</li> </ul> <p><b><u>Guidance</u></b></p> <p>One issue that has come up on a number of the root cause analysis investigations is that audit teams have different ideas about what constitutes applicable audit evidence and what should be retained on file. A consistent message will be created in the form of a guidance document and circulated in time for use on December 2017 year ends.</p> <p><b>Audit of Revenue Recognition</b></p> <p>Consideration of the strategy for the audit of revenue was a key focus of the mandatory training undertaken for the audit stream in autumn 2016. This included the focus on completeness of revenue and ensuring that all revenue that should have been recognised was.</p> <p>As we noted in our 2017 FRC public report, guidance was issued in September 2016 in relation to the use of substantive analytical</p> |
|--|--|---|

|  |  |  |
|--|--|--|
|  |  | <p>procedures (SAPs) particularly in areas such as revenue to ensure appropriate expectations can be set before this type of testing is used as a response to risk.</p> <p>We are currently in the process of developing guidance detailing the use of cash received as audit evidence to confirm the completeness of revenue, when this is appropriate and issues to consider.</p> <p>We will continue to keep a watching brief on this area via the internal AQAR process and respond accordingly.</p> <p><b>Ethical and Independence Requirements</b></p> <p>We note that in general our systems and arrangements for ensuring compliance with ethical and independence requirements are sound and we have made continuous improvements over the past few years. One area where we have had a small number of issues arising is the appropriate and timely consultation with the ethics partner on independence matters. We performed a root cause analysis early in 2017 to investigate this issue. As noted in our 2016/17 AQR public report:</p> <p>‘Whilst not extensive in number we acknowledge that there are still circumstances arising where the ethics partner is not consulted appropriately and on a timely basis. We undertook a root cause analysis to investigate what how to reduce even further the number of incidents where</p> |
|--|--|--|

|  |  |  |
|--|--|--|
|  |  | <p>teams and individuals fail to follow correct procedures.</p> <p>A number of causes were identified:</p> <ul style="list-style-type: none"><li>• Partners are required to complete a number of different forms for different reasons, which means the process is not always efficient and information can be missed – we are reviewing this process and the potential for simplification.</li><li>• The audited entity may engage directly with other parts of our business for non-audit services without fully appreciating the complexity of the independence requirements. As noted earlier in this report we are designing new communications for new and existing clients covering the legal and ethical regime in place for public interest clients.</li><li>• Where audited entities become public interest for example, due to an increase in market capitalisation, they do not always inform us on a timely basis and this leads to implications for our independence. In order to address this issue we need to ensure that there is a process in place at the planning and completion stages of the audit to confirm with the audited entity any changes in status.</li></ul> |
|--|--|--|

|   |   |  |
|---|---|--|
|   |   | <p>We are reviewing our engagement take on process to assist in the timely notification and evaluation of any non-audit services. ‘</p>  |
| <p>AQR review on PSAA work (across all firms)</p> | <p>The risk assessment of Property, Plant and Equipment (PPE) should consider the impact on the risk of misstatement over the account balance caused by estimation uncertainty and valuation policies requiring periodic valuations.</p> <p>Ensure that sufficient challenge and independent corroboration is made of management experts’ valuations of property, plant and equipment PPE and other fixed assets;</p> <p>Better evidence audit work over the valuation of pension scheme assets, testing of data provided to actuaries and direction and review of the pension fund auditor;</p> <p>Evidence procedures to test the completeness, authorisation and appropriateness of journals, and ensure that risk characteristic testing is comprehensive;</p> <p>Ensure that client take on procedures are evidenced on first year audits. Prior year significant risks and issues should be evidenced as part of the audit team’s risk assessment;</p> <p>Evidence the decisions taken to support the testing rationale for operating expenditure and the testing of completeness of expenditure and liabilities; and</p> | <p>The Public Sector Assurance (PSA) team is completing a Root Cause Analysis exercise, independently facilitated by our Technical Standards Group (TSG), to determine the causal factors to our weaker quality scores in 2015/16. This will result in a detailed action plan, the implementation of which will be monitored through the PSA Partners, Directors &amp; Managers group. Progress will be periodically reported from the group to BDO UK’s Head of Audit.</p> <p>All Partners, Directors and Managers have been briefed on the findings of the quality reviews and are required to ensure that they are addressed in the 2016/17 audits and teams are briefed on the specific matters arising.</p> <p>Our risk assessment processes already require us to consider estimation uncertainty in significant account balances and the risk of material misstatement arising from periodic valuation policies where applicable. However, to improve the process going forward, we will make a rebuttable presumption that PPE valuation presents a significant risk of material misstatement.</p> |

|  |  |  |
|--|--|--|
|  | <p>Ensure that the involvement of the RI in the areas of key audit significance is to the level expected and properly documented.</p> <p>Evidence that enquiry of senior and non-financial management staff is included as part of the audit team's VFM arrangements risk assessment and response to identified significant risks.</p> <p>Evidence account taken of governance issues (e.g. changes to s151 officer, political leadership, matters in reported in Annual Governance Statement) in providing VFM arrangements conclusion.</p> | <p>We will continue to train our staff to ensure that appropriate professional scepticism is applied when reviewing management experts' valuations of property, plant and equipment and that this is fully documented on audit files. We anticipate that the root cause analysis process will identify further relevant actions to take.</p> <p>We have produced new guidance on the audit of employee benefits. We have also updated our template for recording the use of management experts in respect of the actuary and updated the assurance request letter to the auditor of the pension fund, to support staff with better design and evidence of audit work undertaken in these areas.</p> <p>We will continue to use our data analytics software BDO Advantage to support our journals testing. Our audit approach is already designed to ensure this is addressed and staff will be reminded of the need to improve their documentation in respect of journals.</p> <p>We have refreshed our audit working papers for recording our review of predecessor auditor files for new clients, and consideration of prior year significant risks, to address these issues.</p> <p>RIs have been reminded of the need to evidence their appropriate and timely engagement in the</p> |
|--|--|--|

|                      |   |   |
|----------------------|---|---|
|                      |   | <p>audit, with sufficient depth of input to areas of key audit significance.</p> <p>We have refreshed our VFM assessment work programmes and reminded Partners, Directors and Managers involved in VFM work of the need to retain appropriate evidence on file.</p>   |
| Financial statements | <p>Obtain better evidence to support asset valuations;</p> <p>Better documenting audit sampling, journals testing and the validity of information prepared by the entity; and</p> <p>Have clearer documentation on file of the extent of Engagement Quality Control Reviewer involvement.</p> | <p>The Public Sector Assurance (PSA) team is completing a Root Cause Analysis exercise, independently facilitated by our Technical Standards Group, to determine the causal factors to our deteriorated quality scores in 2015/16. This will result in a detailed action plan, the implementation of which will be monitored through the PSA Partners, Directors &amp; Managers group. Progress will be periodically reported from the group to BDO UK's Head of Audit.</p> <p>The detailed findings of the financial statements reviews have been shared with the Partners, Directors and Managers involved in the assessment in 2016/17 through our technical update training and PSA Partners, Directors &amp; Managers group meetings. It is a requirement for all team members to be briefed on the findings, where they are applicable, on 2016/17 audits.</p> <p>Where an Engagement Quality Control Reviewer (EQCR) is appointed for an audit, the EQCR has</p> |

|                              |   |   |
|------------------------------|---|---|
|                              |   | <p>been briefed on the findings of the 2015/16 quality reviews.</p> <p>Where files were scored '0' in 2015-16 the Head of Public Sector Assurance will work with the Engagement Lead to ensure that processes designed to ensure that quality standards are met are engaged with, and responded to, in a timely and appropriate way e.g. Engagement Quality Control Review and Hot Reviews.</p>                                   |
| VFM arrangements conclusions | <p>Ensure information from different sources is triangulated; and</p> <p>Ensuring clearer documentation on file of the consideration of risks and evidence.</p>   | <p>Root Cause Analysis applies equally to VFM arrangements work.</p> <p>The detailed findings of the VFM reviews have been shared with the Partners, Directors and Managers involved in the assessment in 2016/17 through VFM planning briefings.</p> <p>Where files were scored '0' in 2015-16 a separate Engagement Quality Control Reviewer has been assigned to perform an independent review of the VFM conclusion work.</p> |
| Housing benefit              | <p>Ensuring any qualification letter points contain the level of detail required by the Certification Instructions, completing extended testing where required; and</p> <p>Fully completing the HB COUNT workbooks.</p> | <p>We have refreshed internal HBCOUNT training materials to include an interactive webinar version, completion of which is mandatory for all staff completing or reviewing HBCOUNT work. Completion of the webinar module is monitored and recorded through our learning portal and is available 'on demand' after completion for later reference.</p>  |

|                       |           |   |
|-----------------------|-----------|---|
|                       |           | A sample of qualification letters will be reviewed for template compliance by the HBCOUNT technical lead prior to submission. The sample selection will take into account previous AQAR scores and the relative experience of the team performing the work. |
| Regulatory compliance | No issues | -   |