

# **Audit Quality Monitoring Report 2020**

**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 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 2015**

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## Executive Summary

We are pleased to present our Annual Quality Monitoring Report for 2020. This covers the work of local auditors appointed by PSAA for the 2018/19 financial year, the first under the appointing person arrangements. This report is later than intended because the impact of the Covid-19 pandemic has delayed the completion of the professional regulators' work.

PSAA is committed to good quality audit services being provided to its opted-in bodies. PSAA has adopted the International Auditing and Assurance Standards Board's *Framework for Audit Quality* (IAASB framework) as the model for its appointing person audit service quality monitoring arrangements. This is widely regarded as a definitive statement on overall audit quality. The IAASB framework recognises there is a complex interplay of many factors in audit quality and notes the need for a rounded approach. We have taken the attributes that IAASB Framework expects to be present within a quality audit and distilled them into three tests which we use to monitor the quality of audit services provided by auditors under our contracts:

- Adherence to professional standards and guidance;
- Compliance with contractual requirements; and
- Effective relationship management.

Local audit has had to adapt and respond to a number of significant pressures and challenges over the recent period. High profile corporate failures have led to unprecedented scrutiny of auditors and their regulators, with three government initiated reviews of corporate audit and reporting (Kingman, Competition and Markets Authority, and Brydon) all of which will impact significantly on the firms that currently provide local audit services. Unsurprisingly local audit is facing similar challenges and in September Sir Tony Redmond published his independent review for MHCLG of the effectiveness of local audit and the transparency of local government financial reporting. He drew attention to many of the significant challenges and the unprecedented turbulence which exist in the current local audit system highlighting that at present local government audit is under-resourced and under-valued and is not having sufficient impact. The Government published its response to the review on 17 December, identifying that further work was required to refine the recommendations that had been made.

### Adherence to professional standards and guidance

Information on the quality of local audit work in this report comes from the reports provided by the audit regulators, the Financial Reporting Council (FRC) and the Institute of Chartered Accountants of England and Wales (ICAEW). The FRC issued its audit quality inspection [report](#) (FRC report) containing the results of its audit quality inspections of 2018/19 engagements on 30 October 2020. It also included the results of reviews undertaken by the Quality Assurance Department (QAD) team of the ICAEW, and firms' own internal quality monitoring arrangements. We note that the scope of the report covers the whole of local audit, including those not opted-in to the PSAA appointing person arrangements and NHS bodies, but our judgement is that we are able to use the findings to inform our contract monitoring arrangements.

#### FRC reviews

The FRC is the primary regulator, and it reviewed the audits of 15 of the 271 bodies that meet the major local audit definition (Expenditure in excess of £500 million), 10 local authorities, two other local government bodies and three from the NHS, focusing in particular on audits with 'higher risk attributes'. The report sets out that nine financial statements audits (across four of the seven firms reviewed) did not meet the required standard (which is being

assessed as '1 - good 'or '2A – limited improvements required') for their work on financial statements, and that accordingly urgent action is required by the relevant firms to address the issues concerned; but the results at some of the reviews at some individual firms were encouraging with no more than limited improvements identified.

The FRC report commented specifically on three firms where it reviewed more than one engagement, those with the largest share of major local audits. The FRC reviewed six GT financial statement audits: one was assessed as meeting the required standard, and five as 2B (improvements required). The FRC reviewed two Mazars financial statements audits which they assessed as 3 (significant improvements required). All EY's audits reviewed by the FRC were assessed as meeting the required standard (no more than limited improvement). Two of the remaining four firms inspected (BDO, Deloitte, KPMG and PwC) had audits that required more than limited improvement although these were not named by the FRC.

The FRC report highlights that the quality of audit work on property valuations continues to be its greatest concern and that firms must focus on improvement, some of them urgently. Other areas of concern include the audit evidence for debtor balances, the audit response to fraud risks relating to journals and expenditure, the Engagement Quality Control review process, auditing estimates, and the audit of pension fund assets.

The main areas of concern highlighted by the reviewers have been raised in previous reports. Whilst auditors have responded by increasing their coverage of these areas the FRC report states that some firms still need to do more if its professional expectations are to be met.

We are pleased that the FRC's reviews found that the quality of VFM arrangements conclusion work across all firms remains high, with all 15 reviews meeting the standard. The new Code of Audit Practice will change the scope of the VFM arrangements work from 2020/21 onwards.

#### ICAEW reviews

The FRC report also includes the findings of both the ICAEW reviews of audits of bodies that do not meet the MLA definition, and the firms' Internal Quality Monitoring (IQM) reviews of audits.

The ICAEW reported that 11 of the 12 financial statement audits that they reviewed across all firms met the required standard, along with all of the associated VFM arrangements work.

The IQM results covered 29 individual audits of which 12 related to major local audits. 19 audits were considered to be of a good or limited improvements standard (nine for major local audits), eight were assessed as requiring improvement and two audits were classified as needing significant improvement.

The FRC report cited some good practice examples such as the increased use of internal specialists for property and pension valuation, improved workpapers to record evidence of challenge of management and better risk assessments for VFM arrangements work.

We will follow up the results and resulting action plans of all firms to get assurance that the FRC's concerns are being actively addressed. We are aware that firms have taken steps to respond to the findings by updating their work programmes.

## Effective relationship management

We surveyed all of our 2018/19 Section 151 officers and Audit Committee chairs to judge the effectiveness of relationships between bodies and their auditors. We received responses from 193 (40%) Section 151 officers and 75 (15%) Audit Committee chairs. For 80% of respondents the audit service provided had met their expectations.

The survey also highlighted the known tensions in local audit around resourcing and the topics of specific audit focus.

We have provided firms with details of the anonymised analysis of survey responses to enable them to develop tailored improvement plans where appropriate. Communication is the area where most improvement can be made with delays in reporting the need for an audit deferral or a fee variation highlighted in responses.

## Compliance with contractual requirements

The biggest disappointment for 2018/19 engagements was the very large number (208, 42%) where an opinion was not given by the publishing date of 31 July 2019 set out in the Accounts & Audit Regulations. This compares to 2017/18, the first year with a 31 July deadline, when 65 (13%) opinions were delayed beyond the publishing date. In order to comply with auditing and ethical standards there is no statutory or contractual requirement date for an audit opinion to be provided by the publishing date.

The causes of the delays were identified by auditors as a broadly equal combination of:

- Resourcing issues;
- Dealing with technical audit and accounting issues; and
- Poor quality working papers provided by authorities.

The third of instances where firms did not have sufficient staff to undertake particular audits is symptomatic of the vulnerability that has developed in the local audit market, and the lack of trainees and qualified staff with the appropriate knowledge to undertake this work.

We note that firms are prioritising technical audit quality. The report from the FRC commended a decision to delay reporting where there were significant concerns over areas of audit judgements. Similarly, in a thematic review of Audit Quality Indicators published in May 2020, a firm's decision to defer audit work until it had appropriately experienced resources in place was given as a case study illustrating where an action had prevented poor audit quality.

## Overall

We are disappointed with the results of the professional regulatory reviews of financial statement work, with only 62% reviewed assessed as requiring no more than limited improvements. In contrast all VFM arrangements work inspected met this standard. We have discussed with the firms their plans to address the matters raised by the professional regulators.

The fragility of the local audit market supply was exposed by the proportion (broadly one third) of delayed opinions where audit firms acknowledged that audit resourcing issues were a significant contributory factor. We commissioned a report from [Touchstone Renard](#) (TR) in March 2020 to better understand the stresses on the system. The TR Report was submitted as evidence to the Redmond Review.

Our client survey identified that there are improvements that firms can make in their communications with clients. For 2019/20 we requested firms to engage early on key issues

such as where they believed that a fee variation would be required or a change to the audit timetable was needed.

The IAASB framework notes that all parts of the financial reporting supply chain have a role in contributing to and encouraging an audit environment that supports high quality audits. We will continue to work with regulators, auditors, finance staff and those charged with governance to improve audit quality. Meeting the challenges posed within the Redmond Review will form part of that work.

## Introduction

1 This report summarises the results of the Quality Review Process (QRP) for 2018/19 engagements and related contractual monitoring. This is the first such report produced by PSAA under our appointing person responsibilities conveyed by the Local Audit (Appointing Person) Regulations 2015 (the Regulations).

2 PSAA has a duty under the Regulation 7(b) to design and implement appropriate systems to:

- oversee issues of independence; and
- monitor compliance against contractual obligations.

3 An overall [summary](#) of our approach is provided in on our website

## PSAA approach to audit quality monitoring

4 Our approach is grounded in the International Auditing and Assurance Standards Board (IAASB)'s Framework for Audit Quality. This is widely regarded as a definitive statement on overall audit quality. We have taken the attributes the IAASB expects to be present in a quality audit and distilled them into three tests, which we use to consider the quality of audits and auditors under our contracts:

- adherence to professional standards and guidance;
- compliance with contractual requirements; and
- relationship management

5 Table 1 shows the main evidence sources that PSAA uses to monitor audit quality for the three tests to provide a rounded view of audit quality.

**Table 1 PSAA's audit quality monitoring**

PSAA test	Evidence source
Adherence to professional standards and guidance	Professional regulatory reports; and Firm transparency reports
Compliance with contractual requirements	Contract performance indicators Method statement monitoring
Effective relationship management	Satisfaction survey scores

Source: PSAA

6 The relationship between the IAASB framework and our audit quality monitoring arrangements is shown in the Table 2 below. Audit quality formed a core part of the

evaluation of tenderers in our 2017 audit procurement. Tenderers were encouraged to have regard to the IAASB Framework in the development of their submissions.

**Table 2 IAASB Framework elements**

Key element/PSAA test	Adherence to professional standards and guidance	Compliance with contractual requirements	Effective relationship management
<b>Inputs:</b>			
Values, ethics and attitude	Y	Y	Y
Knowledge, skills, experience and time	Y	Y	Y
<b>Process:</b>			
Audit process and quality control procedures	Y	Y	
<b>Outputs:</b>			
Auditors' reports	Y	Y	Y
Transparency reports	Y		
Professional regulators' reports	Y		
<b>Key interactions</b>	Y		Y

Source: PSAA

7 While responsibility for providing audits of appropriate quality rests ultimately with an appointed auditor, audit quality, efficiency and effectiveness are a shared responsibility: for appointed auditors and audit firms; for PSAA as Appointing Person; for chief finance officers (CFOs) and audit committees; for regulatory and supervisory bodies; for the Comptroller & Auditor General (C&AG) and the National Audit Office (NAO); and for government. The IAASB framework notes that all parts of the financial reporting chain have a role in contributing to and encouraging an audit environment that supports provision of an audit service of the expected quality.

## Adherence to Professional Standards and guidance

8 Information on the firms' adherence to professional standards and guidance comes from the results of professional regulatory reviews completed by the Audit Quality Review team (AQR) for the Financial Reporting Council (FRC) and the Quality Assurance Department

(QAD) for the Institute of Chartered Accountants in England and Wales (ICAEW), the principal Recognised Supervisory Body (RSB) for local audits in England.

9 The AQR reviews a sample of the largest local government and NHS audits. These are known as 'major local audits' and are those bodies with income or expenditure above £500 million. The QAD reviews a sample of local audits that fall below this threshold. The regulatory reviews covered both financial statement and VFM arrangements work. The publicly reported results cover local government and police bodies which have not opted-in to the PSAA appointing person arrangements as well as NHS bodies. However, our judgement is that we are able to use the findings as reported to inform and support our contract monitoring arrangements.

10 The professional reviews focus on identifying areas where improvements are required and individual ratings will reflect a wide range of factors, which may include size, complexity and risk of the individual audits selected for review. The FRC notes that because of this and the small non-statistically valid nature of the review sample, the inspection findings may not be representative of audit quality across a firm's entire major local audit portfolio. Nonetheless, any inspection cycle which identifies audits requiring more than limited improvements is a cause for concern and indicates the need for a firm to take action to achieve the necessary improvements.

11 The FRC issued its audit quality inspection [report](#) on 30 October 2020. This contained the results of its reviews, those of the ICAEW regarding non-major Local Audits, and also the firms' own internal quality monitoring. This provided the results of 56 audit file reviews, although VFM arrangements work was not reviewed in every case.

## Financial Statements

12 Auditors are required to give an opinion on whether the financial statements of an audited body give a true and fair view of its financial position and of its income and expenditure for the period then ended. They have other reporting responsibilities with respect to the preparation of the financial statements, the remuneration report and other information published with the financial statements.

13 The FRC reported that not all firms were consistently achieving the necessary level of audit quality and that urgent action is required from auditors to respond to their findings and improve audit quality. They also reported that the results at some individual firms have been encouraging with no more than limited improvements identified.

14 The FRC report commented specifically on three firms where it reviewed more than one engagement, those with the largest share of major local audits. The FRC reviewed six GT financial statement audits: one was assessed as meeting the required standard, and five as 2B (improvements required). The FRC reviewed two Mazars financial statements audits which they assessed as 3 (significant improvements required). All EY's audits reviewed by the FRC were assessed as meeting the required standard (no more than limited improvement). Two of the remaining four firms inspected (BDO, Deloitte, KPMG and PwC) had audits that required more than limited improvement although these were not named by the FRC.

**15** Those firms with audits requiring limited improvement are required to complete and submit a root cause analysis to the FRC and put in place an audit quality action plan across local audits.

**16** The most significant quality findings related to challenge and corroboration of the valuation of properties (council dwellings, specialised properties and investment properties), improvements required in the audit of amounts receivable (sample sizes and the assumptions used for expected credit loss provisions), and improved audit responses required to the risk of fraud arising from management override of controls and fraud in expenditure recognition. Given the findings on higher risk areas the FRC have challenged the effectiveness of the 'second partner review' process or Engagement Quality Control Review (EQCR). In the report the areas for improvement are detailed as:

- significantly strengthen audit procedures and challenge of management and their own valuation experts in the testing of property revalued in the year;
- improve the level of evidence obtained over amounts receivable, particularly sample sizes and the assumptions used to value credit losses for financial receivables;
- strengthen the audit response to the risk of fraud arising from management override of controls;
- improve the consideration of the risk of fraud in expenditure recognition and the extent of testing around the completeness and occurrence of expenditure;
- design and execute appropriate audit procedures to assess the estimates to determine liability provisions; and
- enhance the procedures over defined benefit pension arrangements, with improvements in the sufficiency of audit work performed over pension fund assets.

**17** We note that the current statutory environment following International Financial Reporting Standards requires a valuations basis on which auditors express a true and fair opinion. The views of local government practitioners expressed in the Redmond Review were *that the extent and nature of asset valuations, very relevant in a commercial setting, undertaken by auditors, have limited significance in local government where assets are more often than not critical to service delivery and "market value" is not a consideration*. The Redmond Review also noted the FRC's view that if the sector considers the focus on asset and pension valuations is inappropriate, then this can be resolved through modifications to the Accounting Code. Accordingly, Sir Tony has recommended that CIPFA/LASSAC review the format and content of local authority accounts.

**18** The FRC also highlighted the proportion of the audits they inspected (48%) that contained a prior period adjustment. Whilst these adjustments can be the result of changes in accounting policies or management reporting configurations, they can also be the result of errors which are a concern for both preparers and auditors of accounts.

**19** There is a clear message in the FRC report for firms to provide stronger challenge management in these areas of complexity and forward-looking judgement. Until this matter is resolved the audit of these areas will continue to be a point of contention between auditors and those that they audit, but auditors must strive to meet the requirements of the statutorily appointed regulator.

20 Table 3 shows the results of this year’s inspection reviews together with those from earlier years completed under the post-Audit Commission transitional arrangements which included firm’s internal quality monitoring results moderated by PSAA.

**Table 3 Financial statements – inspection review gradings**

Results of the reviews completed by engagement year

Grading	Total 2018/19*	Total 2017/18	Total 2016/17*
1 or 2A – Good or Limited improvements required	17	20	31
2B – Improvements required	8	11	13
3 Significant improvements required	2	4	8

*\*sample includes NHS and other bodies not within the PSAA contract*

*Source: FRC audit quality inspection report*

21 As noted above, the sampling methodology means that changes in ratings from one year to the next are not necessarily indicative of any overall change in audit quality. Nevertheless, any inspection cycle with audits requiring more than limited improvements is a cause for concern and indicates the need for a firm or firms to take action to achieve the necessary improvements. In commenting on its findings within Appendix 2 to the FRC report the ICAEW noted that assessing an audit as needing improvement or significant improvement does not mean that the audit opinion was incorrect or that the financial statements were materially misstated.

22 Following each review the FRC sent a private report to each Audit Committee Chair, with a meeting to follow (at the discretion of the audited body) where the quality of the audit was assessed as requiring more than limited improvement. We are pleased that the FRC is giving greater support and attention to the role of the local government Audit Committee Chair discussing risk and concerns over the audit process.

23 The FRC report did highlight a number of specific examples of good practice including in some of the areas where they have raised concerns. Such examples included:

- audit work to corroborate key property valuation assumptions and valuation movements to independent sources;

- use of internal specialists to assist with the audit of pension liabilities and property valuations;
- improvements in calculating an individual local audit body's share of the overall defined benefit pension scheme;
- bespoke approach to testing capital spending and
- robust challenge to the sign-off of the auditor's report until the authority responded with additional information and reconciled balances.

## Value for money arrangements

**24** Auditors are required to give a value for money (VFM) arrangements conclusion as to whether the audited body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

**25** We are pleased that the improving trend within the assessments of VFM arrangements work has continued albeit on a limited sample. The FRC reported for their 15 reviews that the audit work to support the VFM arrangements conclusion was satisfactory in all cases as shown in Table 4. Separate information is not available on the results of the ICAEW or internal quality monitoring results, but the ICAEW reported that the work to support VFM arrangements conclusion was satisfactory on all audits that they reviewed.

**Table 4 VFM arrangements – inspection review gradings**

Results of the reviews completed by engagement year

Grading	Total 2018/19*	Total 2017/18	Total 2016/17*
1 or 2A – Good or Limited improvements required	15	20	31
2B – Improvements required	0	11	13
3 Significant improvements required	0	4	8

*\*sample includes NHS and other bodies not within the PSAA contract*

*Source: FRC audit quality inspection report*

**26** We note from both the Redmond Review and the NAO's consultation on its 2020 Code of Audit Practice that whilst the technical quality of auditors work is rated highly by regulators, the VFM arrangements conclusion is viewed by many local bodies to be an exercise of limited value to them as it is too retrospective and often states what the local body already knows. The new Code of Audit Practice operable from 2020/21 attempts to

address these concerns with the introduction of a VFM arrangements commentary as part of a more tailored Auditor's Annual Report.

## Transparency Reports

**27** The FRC's Local Auditors (Transparency) Instrument 2015 requires firms that conduct major public audits to report annually on information specific to their local audit responsibilities and includes inter alia:

- a statement on the effectiveness of the functioning of internal quality monitoring arrangements in relation to local audit work;
- a description of independence procedures and practices, including a confirmation that an internal review of independence practices has been conducted;
- a statement on the firm's policies and practices to ensure that Key Audit Partners continue to maintain their theoretical knowledge, professional skills and values at a sufficiently high level; and
- confirmation that all engagement leads are competent to undertake local audit work and staff working on such assignments are suitably trained.

**28** The Transparency Reports published by firms in December 2019 provide information on the results of regulatory reviews of 2017/18 engagements and the responses of firms to the matters raised. Some firms produce a specific 'Local Audit' Transparency Report, whilst others adopt the practice of publishing a firm-wide Transparency Report. Transparency Reports can be found on firms' websites.

**29** We found that the required disclosures were contained within each contracted firm's Transparency Report but these were not always clear. Arguably it is more helpful for the sector's stakeholders if a separate report is produced covering 'Local Audit' requirements or, if a single report is produced, the matters pertaining to Local Audit are clearly delineated.

**30** The reports also present an opportunity for the firms to:

- provide relevant, reliable and useful information that facilitates engagement between firms and users of financial information;
- communicate a balanced self-assessment of the challenges the firms face in relation to audit quality and the effectiveness of their actions to overcome them, including how the independent non-executives at the firms have assessed this; and
- promote confidence (where warranted) in their systems, processes and governance to engender public trust.

**31** The Transparency Reports do acknowledge the commercial pressures that the firms are under, identifying both the availability of resources and client risk (corporate governance and quality of management) as well as economic returns as factors that are being used in the evaluation of audit portfolios and decisions on whether to participate in future tenders.

**32** We note that the FRC reported on a review of the 2018 Transparency Reports (which included the local audit disclosures) in September 2019. This found that the reports tended to be too long and overly positive and not as effective as intended highlighting that *'The reports would be more useful if they were more balanced and explained more clearly the challenges and risks the firms face in seeking to deliver consistently high-quality audits,*

*along with their assessment of how successful they are being at meeting those challenges’.* The FRC concluded that, for the full benefits of Transparency Reporting to be realised, the existing requirements need to be rethought and that it would begin work on this in 2020.

**33** The Transparency Reports contain confirmations and information on the training and development that is provided for key audit partners and audit staff. The Redmond review reported that ‘many local authorities reported significant concerns about the knowledge and expertise of staff working on their audit’. Our client survey reported that 25% of Finance Directors did not consider that the audit team had the skills, knowledge and understanding to deliver the audit. This clearly represents a challenge for firms, especially in the context of an overall shortage of experienced local authority auditors in the market.

**34** Firms are due to publish their next Transparency Reports by the end of 2020.

## Compliance with Contractual requirements

**35** PSAA monitors firms’ compliance with contractual requirements by considering performance against a range of contract indicators and also their compliance with agreed method statements.

**36** PSAA has not been required to take formal action against any firm in respect of non-compliance with contractual requirements in respect of 2018/19 engagements.

## Contract performance indicators

**37** During the year PSAA has reported publicly on firms’ performance against targets of particular interest to opted-in bodies. This has included information on delivery of audit opinions and other outputs in a timely manner, and matters which facilitate publication of annual accounts. For clarity, in order to comply with auditing and ethical standards there is no statutory or contractual requirement date for an audit opinion to be provided by the publishing date.

**38** The expectation is that the audit report containing the opinion will be issued by the publishing date set out in the Accounts and Audit Regulations 2015 (or equivalent) wherever the auditor can do so under the auditing standards and the guidance issued by the NAO. This expectation has been written into the NAO Code of Audit Practice from 2020/21 onwards. It is firmly established practice in local government that if auditors are unable to issue an unqualified opinion at the publishing date then rather than issuing a qualified opinion they will delay issue until they can issue a non-qualified opinion. Regulation 10(2) of the Accounts and Audit Regulations 2015 specifically provides for the circumstances where an audit of accounts has not been concluded before the specified publishing date with the requirement of the Council to publish a notice reporting the delay and the reasons for it.

**39** We are disappointed to report that 208 of 486 (43%) opinions were not given by 31 July 2019, a very significant increase compared to the previous year (65, 13%). This is concerning to all local audit stakeholders. We have liaised with NAO, MHCLG and HMT on the progress in completing the remaining audits. In all cases the challenge to return to a ‘normal’ timetable has been exacerbated by Covid-19 pandemic. In addition to local

governance, stewardship and accountability concerns there is an unhelpful knock-on impact on the preparation and publication of audited Whole of Government Accounts. Table 5 below shows that, although progress has been made, 28 2018/19 opinions remained outstanding as at 30 November 2020.

**Table 5 Delivery of audit opinions**

Time profile of the completion of audits: opinions outstanding

Year	31 Jul 2019	30 Sep 2019	31 Dec 2019	31 Mar 2020	30 Nov 2020
<b>2018/19</b>	<b>208</b>	<b>142</b>	<b>85</b>	<b>61</b>	<b>30</b>
2017/18	65	25	14	11	7

Source: PSAA

**40** Firms explained that there were three main reasons for the delays of broadly equal occurrence with some audit delays having more than cause:

- audit resourcing issues;
- dealing with technical audit and accounting issues; and
- issues with working papers or explanations provided in response to audit queries.

**41** The lack of auditor resources where audit firms did not have sufficient staff to undertake particular audits emerged for the first time as a significant factor in 2018/19. This is symptomatic of the vulnerability that has developed in the local audit market and the lack of trainees and qualified staff with the appropriate knowledge to undertake this work. We note that the FRC in its thematic review of Audit Quality Indicators highlighted the positive impact on audit quality of a firm taking the decision to delay the audit timetable at a number of specific clients so that all audits could be resourced appropriately. As noted above the publishing date is not a statutory target.

**42** The bringing forward of the publishing deadline has exacerbated the position by restricting the number of audits that sector specialist auditors can work on, and our understanding is that the intensity of the resulting work has increased the attrition of local audit staff leaving the field.

**43** The other delay factors have also been impacted by the bringing forward of the publishing date. The accounts are described by both CIPFA and Sir Tony Redmond as “impenetrable”, but are being produced by smaller hard pressed teams of accountants with competing priorities, undertaking more complex and innovative transactions, which can result in delays in preparation and resolution as the audit window has been shortened. The Redmond Review reported that auditors raised concerns about local authorities not providing properly prepared draft accounts supported by high quality working papers or not being available to answer audit questions. Scale fees and auditor resource plans are based on the draft accounts and supporting working papers being of an appropriate standard.

44 All parts of the financial reporting supply chain have their role to play in delivering high quality and timely audits. A priority message to firms has been to communicate clearly with bodies on:

- the audit plan and timetable; and
- any changes to that timetable and the reasons concerned.

#### Objections

45 Local audit is different from corporate audit in that the appointed auditor has certain statutory powers under the LAAA 2014, and also that local electors have the right to raise objections.

46 The nature of individual objections and the levels of complexity they involve vary enormously. For simplicity we monitor against the expectation that cases should be resolved within nine months from the point at which the objection is accepted by the auditor for review. We recognise that this timetable cannot be achieved in all cases, for example, where objections are related to complex or difficult legal cases, or where a resolution is delayed because an auditor is reliant on others for responses.

47 The NAO's 2020 Code of Practice will require auditors to use best endeavours to complete their work on objections within six months including informing the objector and the body of their decision. We welcome particularly the requirement that where this is not possible that electors and bodies will be provided with a progress update every three months until the objection is decided.

#### Non-compliance with Terms of Appointment

48 There have been no significant areas of non-compliance with PSAA's Terms of Appointment (ToA). We reported five occasions during the year where firms had not notified us of their intention to issue a qualified VFM arrangements conclusion.

#### Independence issues

49 The ToA require firms to notify PSAA of any potential threats to their independence which may arise. In relation to 2018/19 engagements we received three such notifications. In all cases the matter was dealt with appropriately with relevant disclosures being made to the audit committees of the authorities concerned. There have been seven matters raised with respect to 2019/20. Again these have been dealt with appropriately.

#### *Non-audit services*

50 Firms are able to provide certain non-audit services to audited bodies subject to the requirements of the FRC's Ethical Standard and the NAO's Auditor Guidance Note 1. Where the fee for such services exceeds the higher of £18,000 or 20% of the scale fee then the firm must seek PSSA's confirmation that undertaking such work does not compromise their independence as auditor. The requirement by local auditors to provide a VFM arrangements conclusion is a key consideration in this judgement. The number of requests made has significantly reduced from earlier years because of changes to the Ethical Standard.

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**Table 6 Non-audit service requests**

Number and value of non-audit service requests for the last three financial years

Year	Number of requests approved for non-audit services	Total fee value of requests approved
2017/18	20	£810,134
2018/19	10	£336,773
2019/20	5	£203,550

*Source: PSAA*

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**51** We have no concerns about how firms are operating their internal control systems for maintaining their independence.

#### Complaints

**52** Complaints can be an indicator of poor quality audit services. Under our complaints policy PSAA can consider complaints that relate to a possible failure in service by one of the firms of appointed auditors, but we cannot consider complaints about the professional judgements and decisions made by auditors, or the process followed in relation to elector rights as these are matters for the courts.

**53** In the year to September 2020 there were four complaints to PSAA none of which were upheld. In 2019 there were also four complaints one of which was partially upheld. In one 2020 case a complainant was referred to the ICAEW as the appropriate regulatory body.

#### Method Statement

**54** Certain parts of firms' invitation to tender (ITT) responses in the 2017 PSAA procurement have been incorporated as 'method statements' in their contracts. The method statements cover a variety of topics that were all assessed as part of the tender evaluation process. PSAA has triangulated its monitoring of compliance with audit quality service information from other sources such as the professional regulatory reviews and client surveys. A client focussed version of the 'method statement' was provided to all bodies as part of firms' normal planning and reporting and also alongside our client surveys.

**55** As audit is a highly regulated profession, much of the firms' method statements is contained in the expectations of the auditing standards in planning, conducting and reporting on an audit. The results of the regulatory reviews are reported above.

**56** The findings from our client survey were that broadly 80% of finance directors and audit committee chairs considered that their audit service was meeting their expectations as set out in their method statement. Where this was not the case the main reasons highlighted

were because of 'audit delays' and communications about this and fee variations. The results from the client survey have been drawn to the attention of firms (see below).

### Data Confidentiality

**57** We have reviewed and confirmed that firms' data confidentiality arrangements remain appropriate. There have been no notifiable breaches of data confidentiality. The introduction of cloud-based data holding and two-factor authentication arrangements have done much to improve overall security.

### Social Value

**58** In accordance with our obligations under the Public Services (Social Value) Act 2012, we used the procurement to seek to improve the economic, social and environmental well-being through the supply of audit services under our contract, whilst acknowledging that this is difficult to frame and measure in a national context.

**59** As part of our tendering process we asked that firms specify how many apprenticeships, additional training, development and work experience opportunities would be provided as a result of the contract, and the measures that would be put in place to target these posts at people from more deprived communities. Across our five firms over 400 positions were to be provided across the life of the contract with 90 in place in the first year. Initial information shows that 137 positions were introduced in the first year of the contract.

**60** A particular focus for all firms has been school leaver programmes for those not wishing to go to university (which had been the traditional joining route). Information on backgrounds has been more challenging to validate but firms have provided details of the strategies deployed to target potential employees in more deprived areas such as using blind interview techniques. One firm's intake of 18 school leavers include 15% who had been recipients of free school meals.

**61** Additionally our tendering process asked firms for information on what other economic, social and environmental initiatives they would undertake to deliver related to providing auditing services of their contract lot and what improvements in social value they expected those initiatives to stimulate. These vary by firm and include:

- support for national and local charities;
- committing additional time to social responsibility activities;
- reduction in carbon footprint; and
- supporting social mobility.

### Effective relationship management

**62** Effective relationship management is a key component of audit quality. Satisfaction surveys are the most effective way of obtaining this information.

**63** Previously surveys have been undertaken by the audit firms themselves and have sought the responses of client Chief Finance Officers (CFOs) to a relatively small number of

high level questions. This year was the first under Appointing Person arrangements, and PSAA introduced a new approach which incorporated a number of important changes.

**64** We commissioned the LGA's Research & Information team to administer the survey to provide assurance about independence and confidentiality. The views of both CFOs and Audit Committee Chairs were sought, recognising the importance of the auditor's relationships with both Management and Those Charged With Governance. A longer list of survey questions sought to probe more deeply into respondents' experience of different aspects of the audit and the auditor's performance. We surveyed all our bodies, and we received responses from 75 (15%) Audit Committee chairs and 193 (40%) Finance Directors. We reported the survey results in May 2020. A full copy can be found on our website: [PSAA Quality of Audit Service feedback survey](#).

## Survey Results

**65** The response rate is lower than we anticipated, particularly given the number of delayed opinions.

**66** We hope that response rates will rise in the future and that both CFOs and Audit Committee Chairs will see this mechanism as an important opportunity to provide feedback based on their front-line experience of the audit service. We have commissioned further research for the LGA to help us to improve survey response rates in future years.

**67** The responses from Audit Committee chairs showed that:

- 81% agreed that in presenting the audit closure report the auditor clearly explained the work undertaken and conclusions reached;
- In cases where an additional fee had been proposed (41), audit committee chairs agreed that in 83% of cases the audit team had explained the reasons for this, and in 72% of cases this had been reported to the Audit Committee on a timely basis; but
- Of the 32 cases where the audit opinion was to be delayed, 56% reported that the delay had not been communicated on a timely basis.

**68** The responses from Finance Directors showed that:

- 74% said that the auditor could be approached as a sounding board when required;
- 25% did not think the audit team had the skills to deliver the audit;
- 70% thought they had been kept informed of audit progress throughout the year;
- In those cases where an additional fee had been proposed (148), 62% agreed this had been reported on a timely basis; and
- Of the 84 cases where the audit opinion was to be delayed, 58% reported that the delay had not been communicated on a timely basis.

**69** We have shared the information with firms to assist in improving the quality of audit services. All firms wanted the additional comments provided and information on a more granular level than is available from an anonymous survey. Three of the comments made are provided below, illustrating the range of responses provided:

- *'A frustrating year due to change in audit approach, especially around asset valuations and due to a new team. Likelihood that audit would not complete in time communicated very late';*
- *'The first year audit from a new provider can be challenging. However in this instance the transition was seamless'; and*
- *'The auditors and councils are subject to a huge amount of regulation and the whole process of producing a statement of accounts and auditing them is expensive. We end up with a product that is not meaningful to our residents or councillors'.*

**70** Overall, the survey results show that 80% of respondents were content with the quality of the audit service provided, but the known tensions in the local audit world around resourcing and property and pension valuations were highlighted. The nature of the survey means that it is difficult to draw meaningful comparisons between firms but there is work to be done by all to achieve improvements. Together with the other elements of our monitoring the survey results provide a strong evidence base from which firms will be able to develop tailored improvement plans where appropriate.

## **Actions**

**71** The FRC report contains the firms' responses to its findings. All highlight the ongoing investment that they are making to their audit training and procedures and the firms' oversight of the process. Some are undertaking Root Cause analysis to identify and understand the drivers for the identified poor quality audit work. This will be used to make changes to training, work programmes and review processes.

**72** Where necessary the FRC will assess the firms local audit quality action plan and decided whether any additional procedures or increases audit reviews are required at individual firms.

**73** We will be discussing with all firms the results of the reviews and the responses that they are putting in place. We meet with all firms on a regular ongoing basis to discuss delivery of the contract and the quality of audit service provided.

