

Audit Quality Review Process

Annual report

November 2009



The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

Contents

Introduction	3
Background	4
QRP results	5
Responses to QRP findings	8
Contacting us	9

Introduction

- 1 The Audit Commission appoints external auditors, from either its own staff (the audit practice) or private firms of auditors,ⁱ to 900 principal local government, criminal justice and health bodies in England. The Commission also appoints external auditors to some 9,500 parish and town councils and other bodies such as internal drainage boards, referred to as smaller bodies in this report. These bodies are subject to a separate limited assurance audit regime by a mainly different group of audit suppliers.ⁱⁱ
- 2 Appointed auditors' responsibilities are set out in the Audit Commission Act 1998. They must carry out their work and exercise their powers in accordance with the Commission's Code of Audit Practice (the Code).
- 3 The principal means by which we monitor the quality of auditors' performance is through the annual quality review process (QRP), the aim of which is to:

provide assurance that the Commission's audit suppliers have suitable systems and procedures in place to ensure the quality of work delivered at audited bodies.
- 4 As the regulator of the local public audit regime, the Commission must be able to provide assurance to the bodies we audit and other key stakeholders that the audits carried out by its suppliers are of an appropriate quality. To be credible, such assurance needs to be – and be seen to be – wholly independent.
- 5 To ensure such independence, the quality of the financial statement audits carried out by the audit practice was reviewed, for the second year, by the independent Audit and Inspection Unit (AIU) of the Financial Reporting Council. We have published a summary of the findings of the AIU inspection, together with the results of other quality monitoring activity relating to the audit practice, in the audit practice's annual quality report.
- 6 To further enhance the independent element in the Commission's QRP we also asked the AIU to begin a programme of reviews of the quality of the financial statement audits carried out by the firms, and the results of these reviews are included in this report.
- 7 This report summarises the results of our 2009 QRP programme for our stakeholders, which include government departments, audited and inspected bodies, the wider accounting and auditing profession and other interested parties.

ⁱ Baker Tilly, Deloitte, KPMG, Mazars, PKF, PricewaterhouseCoopers, and Grant Thornton.

ⁱⁱ In addition to the audit practice and Mazars these are BDO, Clement Keys, Hacker Young, Lubbock Fine, and Moore Stephens.

Background

- 8 This year our QRP included assessing the quality of:
- the opinions given on financial statements;
 - the evidence supporting auditors' use of resources assessments and the associated value for money conclusions;
 - the written audit reports to audited bodies;
 - the certification of claims and returns for grant-paying bodies; and
 - compliance with our regulatory requirements.

QRP results

- 9 Overall, the audit practice and the firms have continued to produce work which meets our quality requirements. The risk of an auditor issuing an unsafe opinion or failing to meet our regulatory requirements remains low. However, across all suppliers we also found that:
- there is scope for improvements in the quality of evidence on file to support use of resources assessments;
 - despite the emphasis we have placed on the importance of good audit reporting, and the efforts of suppliers in response, the quality of written reports has not improved, compared with last year; and
 - compliance with our regulatory requirements is generally good.
- 10 The rest of this report summarises the results of our work on each of the main parts of our QRP.

Financial statements audit work

- 11 Auditors of listed companies have a statutory obligation to produce an annual transparency report, giving information about the firm's structure, governance and its arrangements for ensuring the quality of its work. All of the firms in our regime have published these reports. The audit practice also covers these requirements in its annual quality report.
- 12 We have been able to place reliance on the work of the AIU, which reviews the firms' firm-wide systems and processes for ensuring audit quality and reviews a sample of their audits of public interest entities. For the first time, in 2008 the AIU published public reports on each of the big four and other significant audit firms, including all of the suppliers in our regime. These provide an objective reality check on the self-assessments included in the firms' transparency reports.
- 13 The AIU's public report on its inspections in 2007/08 of the work of the big four and other significant audit firms concluded that: 'The AIU public reports indicate that the senior management of the seven major firms are committed to audit quality and have quality control procedures in place that are appropriate to their size and the nature of their client base.' (*AIU 2007/08 Audit Quality Inspections – An Overview*).
- 14 The AIU reviewed seven audits at the audit practice and two each at two firms. We also placed reliance on audit suppliers' internal quality monitoring reviews. While some scope for improvement was identified, we did not identify any systematic or serious concerns about the overall quality of work. The risk of an auditor issuing an unsafe opinion on a set of financial statements remains low.

Value for money conclusions and use of resources assessments

- 15** For each audit supplier we reviewed a sample of auditors' value for money conclusions and the associated use of resources assessments. The aim of these reviews was to assess whether the evidence on the audit file was sufficient to support the auditor's judgements.
- 16** Our overall conclusion is that the evidence on the audit files was sufficient to support the judgements and assessments given, and there was no evidence that any unsafe value for money conclusions had been given. However, there is scope for improvements in the quality of evidence recorded on audit files to support the judgements being made.

Audit reporting

- 17** This aspect of the QRP reflects the importance we attach to good-quality reporting, which is essential if our audit work is to have the desired impact and secure beneficial change. We asked a group of readers (comprising Commission Board members, the Chief Executive, managing directors and other senior staff) to assess audit reports. We reviewed 121 reports including audit plans, governance reports, annual audit and inspection letters and public interest reports. The key questions we asked readers to address were whether the reports were clear, concise and likely to have impact.
- 18** The overall conclusion was that most reports were sound and fit for purpose, but disappointingly the standard of reports had not improved since last year. Readers' findings on the reports included the following.
- The best reports are concise, constructive, balance criticism and praise and are action focused.
 - There should be more use of appendices for supporting details.
 - The implications for the audited body of not taking action to mitigate the key risks it faces should be explained more fully.
- 19** We expect all suppliers to take action to improve the quality of written reports.

Certification of claims and returns for grant-paying bodies

- 20** Government departments, agencies and the European Commission pay billions of pounds of grants each year to local authorities.
- 21** Grant-paying bodies often request certification by an appropriately qualified auditor of the claims and returns submitted to them. Certification work is not an audit but a different kind of assurance engagement. This involves applying prescribed tests that are designed to give reasonable assurance that claims and returns are fairly stated and in accordance with specified terms and conditions.

QRP results

22 For each firm we reviewed a sample of grant claims work, to assess whether the auditor had followed properly our prescribed tests. For the audit practice we relied on the results of an extensive programme of internal reviews, carried out by the Commission's grants team. While there is scope for some improvement in the approach to this work we found that our requirements were being met.

Regulatory requirements

23 We also monitor whether auditors comply with our regulatory requirements, including the various deadlines for issuing audit opinions on the financial statements, giving opinions on the whole of government account returns, producing annual audit and inspection letters and sending us information and returns. In most cases auditors met the deadlines, with only a very few instances where there were delays for reasons that were within the auditor's control.

Limited assurance audit regime

24 The limited assurance audit regime for smaller bodies is operating well. The suppliers have all developed internal quality monitoring processes that are generally robust enough for us to place reliance on. During the year we carried out 36 inspections and placed reliance on a further 36 reviews by the audit practice. No significant concerns about the quality of the work arose from these reviews.

Responses to QRP findings

- 25** All of the audit suppliers have established procedures to report the QRP findings to an appropriate top management group. They are developing action plans to address both organisation-wide and audit team issues and are:
- reporting the results, through the appropriate internal channels, to a national leadership group;
 - sharing the results in detail with all engagement leads;
 - providing training packs for engagement leads to cascade key messages and learning points locally;
 - reviewing internal procedures to ensure the Commission's regulatory requirements are met; and
 - where relevant, taking account of any significant findings from the AIU visit.
- 26** We will follow up significant recommendations as part of next year's QRP.
- 27** In the light of this year's experience we propose to keep the overall shape of the programme including:
- a rolling programme of inspections of final accounts work by the AIU;
 - reviewing a sample of value for money conclusions and the associated use of resources assessments;
 - a product reading programme;
 - reviewing a sample of certification of claims and returns work; and
 - the achievement of key audit reporting deadlines.

If you require a copy of this document in large print, in Braille, on tape, or in a language other than English, please call: **0844 798 7070**

For further information on the work of the Commission please contact:

Audit Commission

1st Floor
Millbank Tower
Millbank
London
SW1P 4HQ

Telephone: 0844 798 1212

Fax: 0844 798 2945

Textphone (minicom): 0844 798 2946

www.audit-commission.gov.uk



Audit Commission

1st Floor
Millbank Tower
Millbank
London
SW1P 4HQ

Telephone: **0844 798 1212**
Fax: 0844 798 2945
Textphone (minicom): 0844 798 2946

www.audit-commission.gov.uk