Governance, Audit, Risk Management and Standards Committee Supplemental Agenda

Date: **Tuesday 1 December 2020**

Agenda - Part I

8. **FRC Report on Quality of Public Sector Auditors** (Pages 3 - 38)
Report of the Director of Finance

Agenda - Part II - Nil

Note: In accordance with the Local Government (Access to Information) Act 1985, the following agenda item has been admitted late to the agenda by virtue of the special circumstances and urgency detailed below:-

Agenda item	Special Circumstances/Grounds for Urgency
8. FRC Report on Quality of Public Sector Auditors	The report was not available at the time the Governance, Audit, Risk Management and Standards Committee agenda was published due to further work which had to be undertaken on the report.

Scan this code for the electronic agenda:

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REPORT FOR:	**Governance, Audit, Risk Management and Standards Committee (GARMS)**
Date of Meeting:	1st December 2020
Subject:	Financial Reporting Council – Audit Quality Inspection Report on Local Audits
Responsible Officer:	Dawn Calvert, Director of Finance and Assurance
Exempt:	No
Wards affected:	All
Enclosures:	FRC – Major Local Audits – Audit Quality Inspection Report October 2020

Section 1 – Summary and Recommendations

This report outlines the recent Financial Reporting Council's report on the quality of local audits of 2018-19.

Recommendations:
The Committee is asked to note the contents of this report

Section 2 – Report

Background

1. The Financial Reporting Council's (FRC) purpose is to serve public interest by setting high standards of corporate governance, reporting and audit, and by holding to account those responsible for delivering them. The Audit Quality Review (AQR) monitors the major audits including those of health and local government bodies.

2. The FRC issued a report in October 2020 on the "Major Local Audits – Audit Quality Inspection". This is the first time the FRC has reported publicly on major audit quality. The scope is to review both the quality of the audit of the financial statements and the conclusion on arrangements to deliver value for money.

3. The assessments were carried out between December 2019 and September 2020.

The Major Local Audits – Audit Quality Inspection Report

4. The FRC inspected 15 audits in respect of the 2018-19 financial statements and value for money conclusions. The sample was taken across seven auditing firms including Mazars this Authority's external auditors.

5. The audit quality inspection review assesses the audit in one of three ways:-

   a) good or limited improvements required, or
   b) Improvement required, or
   c) Significant improvements required

6. The work on 9 (60%) out of the 15 audits assessed on the financial statements reviewed required improvements and the FRC stated this was unacceptable. Detailed comments on each firm assessed (and their responses) are included in the full report which is attached.

7. The report of the Financial Reporting Council (FRC) has reported that their assessment of the quality of the 2 Financial Statement Audits undertaken by Mazar's warranted a conclusion of significant improvement required. This Council is naturally concerned to read about performance issues with its external auditor and the potential impact on the work undertaken by Mazars on the Council's Financial Statements. The Council has read Mazars response to the FRC's findings and welcomes their commitment to improving the quality of their Local Authority work. At this stage no changes are recommended to the Council's external audit arrangements and the Council will stay in regular contact with Mazars about the improvements to its working practices.

8. The quality of the audit work on the conclusions for the value for money was high and continued to improve with assessments requiring no more than limited improvements. Detailed comments on this area of audit work are included within the attached report.

9. Mazars have made a response to show the actions and improvements they are taking which is included in the detailed FRC report (pages 17 - 19) attached.

10. Mazars have stated that their commitment to audit quality is at the core of its values and is dedicated to the continuous improvement of its audit work and the service its provides to its clients.

11. Mazars also confirmed in their reply that they will robustly respond to the findings and already has plans in place to improve the quality of its local audit work.

12. Mazars representatives will be available at the meeting to respond to the reports findings and their firm's reply to FRC.

Legal Implications

13. There are no direct legal implications for this report

Financial Implications

14. There are no direct financial implications arising from this report.

Risk Management Implications

15. There are no direct risk implications, but the indirect concerns / risks have been set out in the body of the report

Equalities implications / Public Sector Equality Duty

16. There are no equalities implications

Council Priorities

17. The audit of the Statement of Accounts provides assurance that the Council has managed and delivered its finances in accordance with its approved plans and budget.

Section 3 - Statutory Officer Clearance

Statutory Officer: Dawn Calvert
Signed by the Chief Financial Officer
Date: 24 November 2020

Statutory Officer: Caroline Eccles
Signed on *behalf of the Monitoring Officer
Date: 19 November 2020

Statutory Officer: Charlie Stewart
Signed by the Corporate Director
Date: 20 November 2020

Mandatory Checks

Ward Councillors notified: *NO, as it impacts on all Wards*

Section 4 - Contact Details and Background Papers

Contact: Paul Gower, Interim Technical Accounting Manager, e-mail paul.gower@harrow.gov.uk

Background Papers: None

Financial Reporting Council

MAJOR LOCAL AUDITS

AUDIT QUALITY INSPECTION

OCTOBER 2020

The FRC

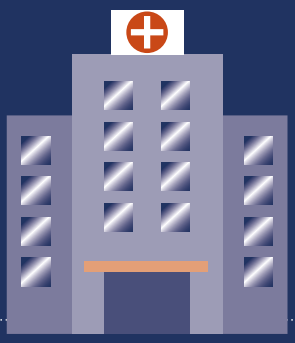
Our purpose is to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them.

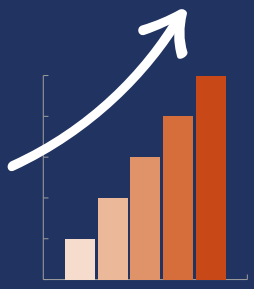
We have responsibility for the public oversight of statutory auditors.

The FRC engages with key Local Audit stakeholders, such as MHCLG, NAO, ICAEW, CIPFA and PSAA in order to contribute to sector-wide initiatives and governance.

AQR

We monitor the quality of the larger Local Audits ("Major") including health and local government bodies.





We promote continuous improvement in audit quality.

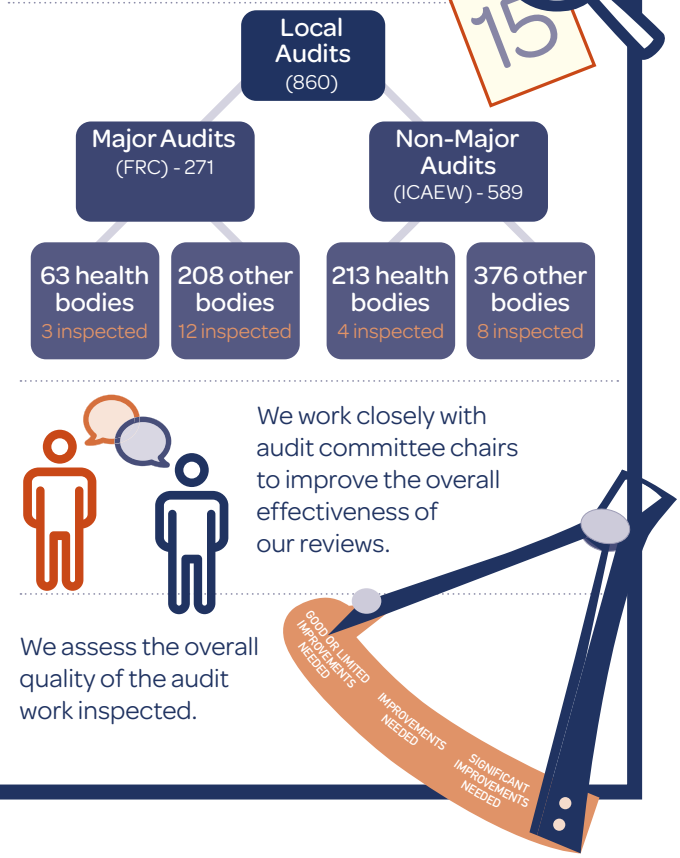
Our team of over 50 professional and support staff has extensive audit expertise to provide rigorous inspection of audit firms completing local audits.

The Firms

Audit firms undertaking local audits	Number of Major Local Audits (within the scope of AQR inspection)[1]	Market Share %	Reviewed by AQR in 2019/20
Grant Thornton UK LLP	109	40.2%	6
Ernst & Young LLP	72	26.6%	3
Mazars LLP	42	15.5%	2
KPMG LLP	25	9.2%	1
BDO LLP	12	4.4%	1
Deloitte LLP	10	3.7%	1
PwC LLP	1	0.4%	1
Total	**271**		15

[1] From data provided by the firms to the FRC in Q1 2019

Our inspection process



The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

We consider all reviews assessed as requiring improvements or significant improvements against the Regulated Framework for Auditing and under the Auditor Regulatory Sanctions Procedure (https://www.frc.org.uk/auditors/audit-quality-review/auditor-regulatory-sanctions-procedure). Where findings indicate that the Registered Auditor has failed to comply with the Framework, the FRC Enforcement Committee can sanction an audit firm for such breaches under the procedures or may refer the conduct in question for consideration under the FRC Accountancy Scheme or the disciplinary procedures of the relevant RSB.

Financial Reporting Council

Major Local Audits

Audit Quality Inspection

Contents

The FRC is the independent body responsible for monitoring the quality of Major Local Audits[1], as defined by the Local Audit (Professional Qualification and Major Local Audit) Regulations 2014. This monitoring is performed by the FRC's Audit Quality Review ('AQR') team. Our reviews of individual Major Local Audit engagements are intended to contribute to safeguarding and promoting improvement in the overall quality of Local Audit auditing in the UK. Audit firms are required to audit the financial statements and Value for Money ("VfM") arrangements conclusion and exercise their statutory reporting powers, as required, in accordance with the Local Audit and Accountability Act 2014.

This report sets out the principal findings arising from the 2019/20 inspection of the seven audit firms completing major local audits in England ("the firms") carried out by AQR. We conducted the inspection between December 2019 and September 2020 ("the time of our inspection"). From 2019/20 onwards we are responsible for inspecting all firms involved with major local audits and will report publicly on our findings, annually.

Our report focuses on the key areas requiring action across the firms, in relation to major local audits, to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the various firm's audit work. Our findings cover matters arising from our reviews of both individual audits and the various firm's policies and procedures which support and promote audit quality.

High quality audit is essential to maintain stakeholder confidence by providing an independent, impartial view of a major local audit body's financial statements and arrangements in place to secure value for money. Poor auditing may fail to alert management, the public and other stakeholders to material misstatements (including those arising from fraud) or financial control weaknesses, in those cases where management have not identified or appropriately amended them.

The combination of management not meeting their responsibilities in this respect and poor auditing could potentially put resources and jobs at risk. We have commented upon our engagement with Audit Committee Chairs on page 8. High quality audit matters and we will drive all audit firms to implement the necessary changes to reach the required standards.

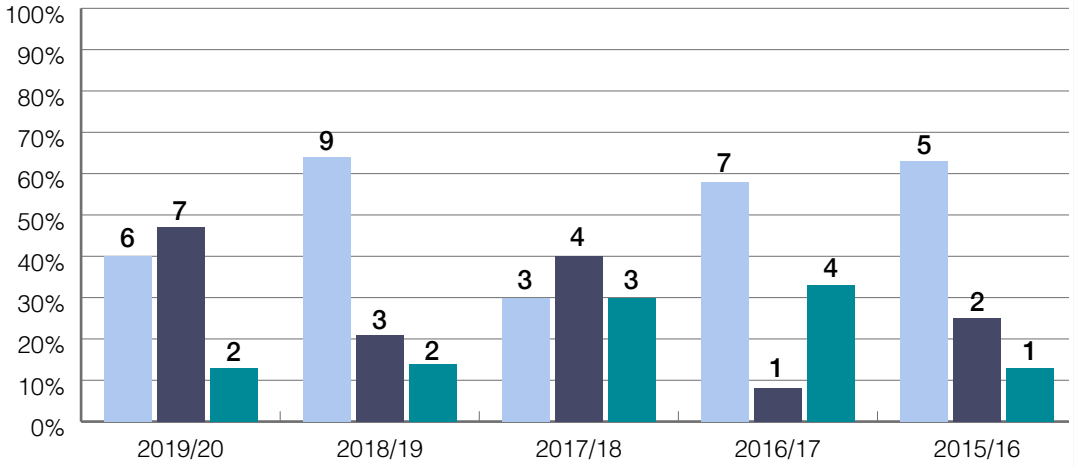
Of the 15 audits and VfM arrangements conclusions that we reviewed in the year across all firms, three were health bodies, two were other bodies and ten related to Local Government Authorities. This included: London Boroughs – 4, County Councils – 3, and 1 each of City, Borough and Metropolitan Borough Councils. We paid particular attention to the following areas of focus: valuation of property (including investment property), multi-employer pension deficits, occurrence and completeness of expenditure, first year audit procedures, the impairment of receivables and the fraud risk assessment and response thereto.

1 The definition of a major local audit is one which meets the following criteria:
- Total income or expenditure of at least £500 million; or
- For a Local Authority pension scheme, at least 20,000 members or gross assets in excess of £1,000 million.

1 Overview

Our assessment of the quality of audits reviewed

Financial statements audit



There were nine audits (60%), that required improvements, which is unacceptable. Furthermore, from our firmwide work, we identified that the proportion of major local audit financial statements containing a prior period adjustment was 36% when the engagement was an initial audit and 12% for a continuing audit. These are extremely high levels and all firms need to consider the causes of this and what changes in their audit approach might be required.

The audits of the local audit bodies' 31 March financial year end accounts are reviewed in the subsequent financial year's FRC inspection cycle (i.e. 31 March 2019 year ends were reviewed by the FRC in the 2019/20 inspection cycle.)

An audit is assessed as good or limited improvements required where we identified either no or only limited findings or concerns to report. Improvements required indicate that more substantive improvements were needed in relation to one or more key findings. Significant improvements required indicate we had significant concerns, typically in relation to the sufficiency or quality of audit evidence or the appropriateness of key audit judgements. The quality results for 2015/16 to 2018/19 above and in the VfM chart below include local audit inspection work completed by the FRC on a consistent basis to 2019/20, but under contract to Public Sector Audit Appointments Limited (PSAA) and reported publicly by them.

The purpose of the annual financial statements is to give members of the public, electors, those subject to locally levied taxes and charges, elected members, employees and other interested parties clear, reliable information about a local audit body's finances. This allows users to understand the financial position of the Body and have confidence in the Body's stewardship of public money and that it has been used and accounted for in an appropriate manner.

The overall results for our inspection of 15 financial statement audits across the seven firms are concerning, with just 40% of audits requiring no more than limited improvement (64% in 2018/19).

Urgent action is required from some of the firms to take appropriate action to respond to our findings to ensure improvements are made in audit quality, given the deterioration in quality in the year.

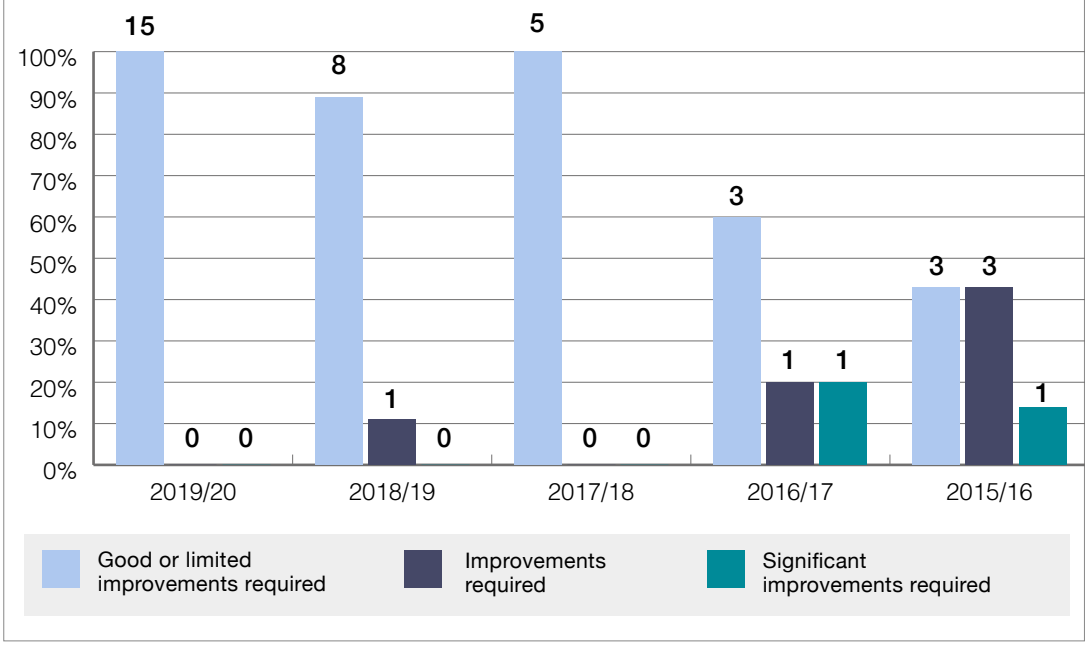
The results of our reviews at some individual firms have been encouraging with no more than limited improvements identified.

We completed 15 audit reviews in 2019/20, more than in previous years. However, resourcing pressures meant that we did not meet our target of 20 reviews.

Changes to the proportion of audits falling within each grading category reflect a wide range of factors, including the size, complexity and risk of the audits selected for review and the scope of individual reviews. Our inspections are also informed by the areas of focus referred to above. For these reasons, and given the sample sizes involved, our inspection findings may not be representative of audit quality across a firm's entire major local audit portfolio; nor do small year-on-year changes in results necessarily indicate any overall change in audit quality at the firm. Nonetheless, any inspection cycle with 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.

Value for Money Arrangements Conclusion

All VfM reviews – for the seven firms inspected



Based on our reviews, the quality of VfM conclusion work across all firms remains high. All 15 reviews were assessed as either good or requiring limited improvements and, unlike the prior year, no reviews were graded as requiring improvement. Over time, we have raised few findings over the firms' work in this area.

Audit firms will need to comply with the new National Audit Office (NAO) Code of Practice, applicable for the first time to 31 March 2021 year-end financial statements, which has changed the scope and auditors' work on VfM arrangements. AQR will continue to monitor VfM arrangements for one further inspection review before monitoring the audit of VfM arrangements under the new Code.

Introduction

Under a new local audit monitoring regime implemented by the Local Audit and Accountability Act 2014, the monitoring of audits of all local bodies has now fully transitioned from the PSAA to the FRC and Recognised Supervisory Bodies.

The FRC has a statutory responsibility for monitoring the quality of major local audits, in England and does so through its AQR team. The monitoring of the audits of non-major local bodies is the responsibility of the accountancy bodies recognised for these purposes by the Secretary of State under statute.

The transition of monitoring of major local audits from PSAA to the FRC started on 1 April 2017, in two phases: initially only for health bodies in respect of financial years ending 31 March 2018; and then for all local audit bodies (largely local government bodies) in respect of their 31 March 2019 financial year end.

This is therefore the first time the FRC has reported publicly on major local audit quality, arising from its inspection activity of financial years ended 31 March 2019.

[2]Reviews by Recognised Supervisory Bodies are overseen by the FRC's Professional Oversight Team, and such oversight activity is reported on separately.

Scope of AQR Audit Quality Inspections

Our scope included reviewing both the audit of the financial statements and the conclusion on arrangements to deliver value for money for each audit selected in 2019/20. We report on this work in the following section.

Our selection of audits for review provided coverage of each audit firm and considered various other risk factors including: the results of previous inspections, the financial position/reserves and activities of certain bodies, results from inspections by other regulatory bodies and issues identified in a body's financial statements, including auditor opinions.

We aim to cover the population of major local audits with the same average frequency as our other Companies Act inspection activities.

Overview of our inspection work

Six (40%) of the 15 audits reviewed in our 2019/20 inspection cycle, across the seven firms, required no more than limited improvements. The number of audits requiring improvements, nine (60%), is unacceptable.

Furthermore, from our firmwide work, we identified that the proportion of major local audit financial statements containing a prior period adjustment was 36% when the engagement was an initial audit and 12% for a continuing audit. These are extremely high levels and all firms need to consider what caused the adjustments and what changes in their audit approach might be required.

2 Details of the scope and results of the ICAEW inspections are presented in Appendix 2

Overall, some firms are still not consistently achieving the necessary level of audit quality and therefore need to make further progress. For two firms, GT and Mazars, the level of audit quality requires significant improvement, and those firms should perform a detailed Root Cause Analysis ("RCA") of the issues we have identified and put in place an audit quality action plan across local audits.

Over the past five years, most of the findings leading to reviews requiring more than limited improvements have been in the areas of: property and pension valuation; completeness and occurrence of expenditure; fraud risk assessment and the associated audit response to those risks; engagement quality control review and audit testing over material balances such as deferred income, PFI arrangements and amounts receivable. These findings often related to insufficient challenge of, and standing up to, management in areas of complexity and forward-looking judgement.

At a firmwide level, some firms have made improvements and we have observed good practices such as, increased use of internal specialists for property and pension valuation, improved workpapers to record evidence of challenge of management and better VfM risk assessments.

We have also seen some instances of good practice from our 2019/20 inspections, and we have seen an example where an audit team delayed its reporting where there were significant concerns over areas of audit judgements. Firms' senior management need to be clear that taking difficult decisions is an appropriate response to improving audit quality. The tone from the top needs to support a culture of challenge and back auditors making tough decisions.

We are also able to report positively that the VfM quality assessment across all firms has continued to improve and all audits reviewed were assessed as requiring no more than limited improvements. This is a pleasing aspect to the firms' work, providing assurance to stakeholders around the VfM conclusions.

We take robust action for all reviews assessed as requiring improvements or significant improvements and will consider all audits assessed as requiring improvements or worse, for consideration of possible enforcement action.

As part of our strategy to improve audit quality, we are increasing our focus on proactive supervision of the largest seven audit firms alongside an enhanced programme of audit inspections. We will identify those priority areas to improve audit quality, request the firms to implement suitable actions to achieve them and hold the firms accountable for delivery.

We wrote to the major audit firms in December 2019[3] setting out elements that we observe consistently on high quality Companies Act audits, especially on high risk engagements. The hallmarks of such audits apply equally to local audits and specific areas of focus should include:

- Significant involvement of partner and other senior team members.
- Good use of specialists.
- Consultation on complex areas.

3 https://www.frc.org.uk/news/december-2019-(1)/letter-to-audit-firms-on-high-quality-audits

- Challenge of management leading to changes where assumptions are too optimistic.
- Robust quality control procedures.
- Clear and timely communication to Audit Committees.

We are moving ahead with plans to increase the transparency of our audit quality assessments through publishing the scope and key findings of each of our individual audit inspections subject to statutory restrictions on disclosure without consent of confidential information. We aim to publish our first set of these reports next year alongside the annual report on local audit.

We recognise the challenges posed currently by the Covid-19 pandemic, both in relation to the level of uncertainty surrounding reliable external valuations and forward estimates, assessment of going concern, inability to carry out physical procedures (for example, stocktakes and other audit work) and assessing management's medium term budgeting plans and savings in order to ensure appropriate arrangements are in place to deliver value for money. We are aware that the National Audit Office has published guidance to auditors for going concern and VfM arrangements and we will consider such matters carefully during our 2020/21 inspection cycle.

Engagement with those charged with governance

We aim to engage in a two-way process to assist those charged with governance in ensuring the highest levels of audit quality and holding their auditors to account.

AQR met with or spoke to all Audit Committee Chairs, or other persons responsible for governance, for all 15 audits selected for review. Initial discussions focused on the role of the Chair, areas of risk they focus upon and any concerns over the audit process. Following our reviews, we sent a private report to each Chair and we plan to meet the Chair again where the quality of the audit was assessed as requiring more than limited improvement.

Audit selections

In 2019/20 we selected for inspection an increased number of audits with higher risk attributes. We define audits as higher risk where the Body: is a higher-risk category or geographic location; is experiencing financial difficulties or reducing levels of financial reserves; has balances with high estimation uncertainty; or the auditor has identified governance or internal control weaknesses. Higher-risk engagements frequently require audit teams to assess and conclude on complex judgemental issues.

We accept that our increased focus on higher-risk audits means that the grade profile of our inspection findings may be less representative of audit quality across the whole portfolio of an audit firm. The change in our approach to audit selection over time also means that historical comparisons of results need to be treated with care.

Reviews of individual audits

Our key findings covered a variety of areas of the firms audits, including audit work over both balance sheet and income and expenditure line items and the response to fraud, effectiveness of Engagement Quality Control review and use of reporting powers. The areas for improvement are set out below:

1.1 Financial statement audit

Significantly strengthen audit procedures and challenge of management and their own valuation experts in the testing of property revalued in the year

Local audit properties are usually the largest asset on a balance sheet and their accurate valuation helps to ensure consistency for the Whole of Government Accounts (WGA), provides a measure of the governance and management of property assets and enables effective medium term property decisions to be made for the benefit of stakeholders.

The quality of audit work over property valuations continues to be our area of greatest concern and where all firms must focus on improvement, some urgently. This covers all of Council dwellings, specialised and investment properties. Improvements are needed in the audit work over completeness and appropriateness of council dwelling beacon valuations, the challenge and corroboration of valuation assumptions and properties not revalued in the year.

We also identified instances where audit teams did not test the completeness and accuracy of the source data provided to, and used by, management's expert when valuing property.

Importantly, the CIPFA/ LASAAC Code of Practice on Local Authority Accounting requires properties to be held on the balance sheet on a valuation basis. Consequently, and as a result of the judgemental nature of revaluations, auditors need to perform sufficient testing in order to conclude that financial statements show a true and fair view, within the materiality applied.

Virtually all local audit bodies are assessed, by their auditors, as having a significant audit risk over the valuation of property.

Improve the level of evidence obtained over amounts receivable, particularly sample sizes and the assumptions used to value expected credit losses for financial receivables

The calculation of expected credit loss in local government bodies involves significant management judgement and estimation uncertainty, with the aggregate amount for impairment loss representing a material proportion of gross receivables. Auditors need to perform additional procedures to conclude that the credit losses were complete and accurate, together with source data used by management.

Strengthen the audit response to the risk of fraud arising from management override of controls

Journal entry testing is a key audit procedure to address the risk of fraud. Auditors should undertake appropriate procedures to assess the risks and design procedures to test a sample of journals for fraud risk characteristics. We identified audits with insufficient evidence supporting: the sufficiency of fraud risk characteristics when profiling and testing journals; the rationale for not testing certain types of journals and how audit teams were able to conclude that testing a small number of journals was sufficient to address the fraud risk.

Improve the consideration of the risk of fraud in expenditure recognition and the extent of testing around the completeness and occurrence of expenditure

In the public sector, auditors should focus on the risk of fraud and error on expenditure. The validity of recorded expenditure is of importance to users of the accounts as financial planning, including savings plans, will be based upon it.

Improvements are required in teams' understanding of the nature of expenditure and, as a result, ensuring they perform sufficiently large sample testing. Furthermore, several audits failed to test appropriately the completeness of expenditure and testing of transactions in a suitably long post year end period.

Improve the robustness of the Engagement Quality Control ("EQC") review processes

The EQC reviewer is required to evaluate objectively the significant judgements made and conclusions reached by the engagement team. We noted deficiencies in the EQC review on five audit reviews.

Design and execute appropriate audit procedures to assess the estimates used to determine liability provisions

Recognition and measurement of provisions and contingent liabilities is judgemental and involves key assumptions and estimates, which might be impacted by reporting bias. Auditors should perform appropriate procedures to assess the completeness, accuracy and reasonableness of assumptions and estimates used to calculate provisions and we identified deficiencies in some testing performed by teams.

Enhance the procedures over defined benefit pension arrangements, with improvements in the sufficiency of audit work performed over pension fund assets

Most Local Government bodies are members of various multi-employer defined benefit pension schemes, with each member body including a share of the scheme liability on its own balance sheet. We identified required improvements in the levels of assessment or evaluation of the Pension Fund Auditor's work over the valuation of the pension scheme assets, in the testing of source data for pension liabilities and the audit challenge over harder-to-value pension assets (those categorised as Level 3).

Where appropriate, improve the evidence of judgements taken by auditors in their exercise of special reporting powers (statutory recommendation and public interest reports)

The Local Audit and Accountability Act 2014 ("the Act") imposes reporting powers and obligations on auditors to report instances of unlawful expenditure or activity of health service bodies which are likely to cause a loss or deficiency. In two audits we identified limited evidence of the audit team's assessments and conclusions on issued special reports.

Good practice observations

We identified particular examples of good practice in six of the fifteen audits reviewed, including the following areas:

- **Testing of property valuations in audits of a limited number of firms:** there was corroboration of key valuation assumptions and comparison of valuation movement to independent valuation indices of Gerald Eve and the RICS BCIS index.
- **The extent and timing of involvement by the Engagement Leader in the audit:** we saw detailed involvement in all aspects of the audit and importantly upfront time spent in reviewing the planning and response to audit risks, ensuring that work programmes fully reflected the required levels of testing.
- **Extensive work performed over the completeness of accruals in a health body:** the team compared accruals to detailed historical trends and balance of accruals to determine that there were no material suppliers excluded from the current year accruals listing.

- **Use of internal specialist to assist with the audit of pension liabilities and property valuations:** while not all firms have the use of internal specialists, where they are available, we have seen their insight enhance the team's audit evidence over these higher risk areas.
- **For the VfM conclusion, performing benchmarking of reserves for a Council and other similar bodies, to inform the evidence over financial resilience.**
- **Robust challenge to delay the sign-off of the auditor's report until the Authority responded with additional information and reconciled balances.**
- **The design and execution of a bespoke approach to the testing of capital project additions:** this provided the audit team with assurance for both the financial statement and VfM arrangements conclusion.
- **Improvements in the way audit firms have audited the calculation of an individual local audit body's share of the overall defined benefit pension scheme.**

1.2 Value for money arrangements conclusion

In our review of the VfM conclusion work of auditors, there were no key findings giving rise to any audit being assessed as requiring more than limited improvement.

Review of firm-wide procedures

This year, our firm-wide work across all seven firms focused primarily on the following areas:

1.1 First year audits and prior period adjustments

There were a total of 215 first year audits in 2019/20, with 90 relating to major local audits. This was an unusually high number of first year audits, resulting from the first year that PSAA appointed auditors to relevant principal local government authorities that had opted into its national scheme. Audit appointments were made for a five year period. Five of the seven firms issued audit opinions on financial statements containing a prior period adjustment. The proportion of major local audit financial statements containing a prior period adjustment was 36% when the engagement was an initial audit and 12% for a continuing audit.

Our key recommendations are that all firms should:

- Perform greater levels of self-review of their audits where they have been auditor for an extended period to ensure that the audit approach remains sceptical and challenging.
- On any future first year audits, enhance their initial audit procedures and enquiries of management and the Audit Committee to cover the potential risk of a prior period adjustment.
- Improve the challenge of management over complete and accurate financial statements, to minimise the number of financial statements containing a prior period adjustment.

1.2 Engagement Quality Control ("EQC") review

The scoping of EQC reviewers across the seven firms saw some variation. Four of the firms assigned an EQC reviewer to all of their major local audits. The remaining three firms appointed an EQC reviewer dependent on risk characteristics. At one firm no major local audits were assigned an EQC reviewer. In aggregate, 32% of major audits had EQC reviewer involvement. Our key findings were:

- Each firm should consider mandatory allocation of EQC reviewers to all major local audit, as such audits would benefit from the rigour and challenge applied.
- Improvements to the process of identifying EQC reviewers, as we noted instances where EQC reviewers had, in the recent past, been engagement leaders on audits assessed as requiring more than limited improvements.
- The EQC process should ensure consistent high quality. AQR has identified some reviews which were allocated an EQC reviewer yet were assessed as needing more than limited improvements.

1.3 Partner and staff matters

Our inspection across the firms included an evaluation of each of the seven firms' policies and procedures and we had no specific findings relating solely to Local Audit. Overall key findings were:

- Improve monitoring of the staff appraisal process and consideration of audit quality in relation to relevant metrics in staff appraisals.
- Enhance the significance of quality in determining local audit partners' and directors' performance ratings and remuneration.

1.4 A&C procedures

The firms all have detailed policies and procedures relating to acceptance and continuance decisions for audited entities. We had no specific findings relating solely to Local Audit. Findings included:

- Enhance controls on continuance decisions to prevent teams undertaking work prior to approval.
- Strengthen the continuance approval process, in particular the evidence to record and explain the conclusions reached.

Firms' internal and ICAEW quality monitoring results

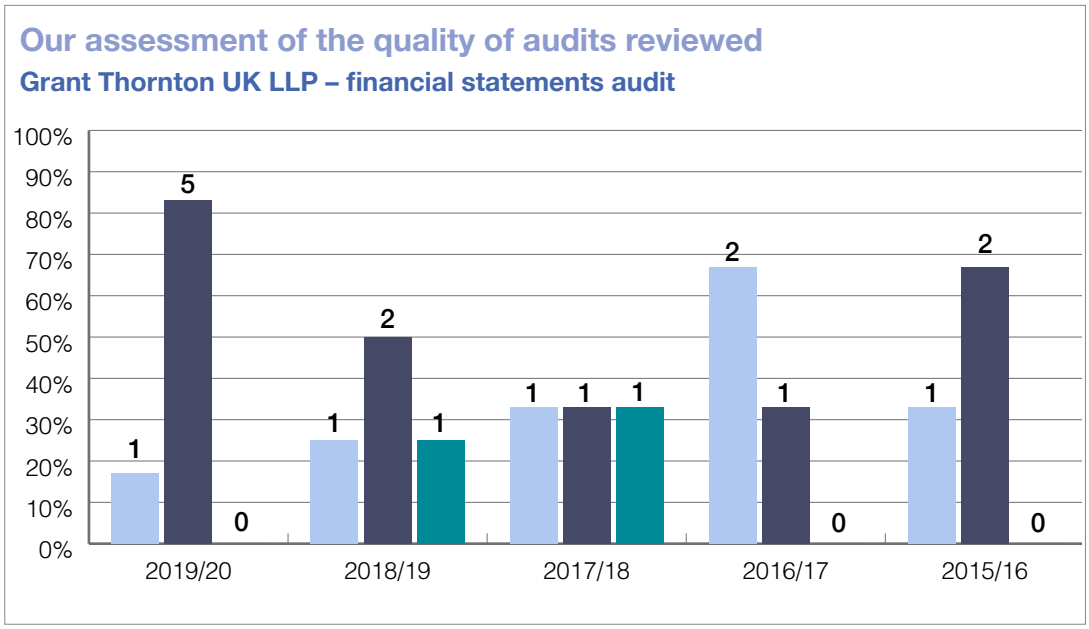
This year we have included, in each of our public reports, summary results of the firms' internal inspection results, together with those of the ICAEW's latest quality monitoring. We consider that these results provide additional relevant information in relation to the assessment of the firm's audit quality.

The results of the firms' internal inspection results, together with those of the ICAEW's latest quality monitoring, are set out in appendix 2.

2 Review of individual firms

We have presented an assessment for the three firms with the largest shares of major local audits: Grant Thornton UK LLP (six audits reviewed), Ernst & Young LLP (three audits reviewed) and Mazars LLP (two audits reviewed).

We completed one audit review at each of the other four firms (BDO LLP, Deloitte LLP, KPMG LLP and PwC LLP) and these four results have been aggregated into one graphical summary and also presented below.



The audit quality results for our inspection of the six audits are unacceptable, with five audits assessed as requiring improvement, although no audits were assessed as requiring significant improvement.

The firm should update its ongoing action plan with the findings and required actions from this inspection cycle. At least two key findings were identified on all audits requiring improvement and therefore areas of focus are the audit of property valuation, assessment and subsequent testing of fraud risks, audit procedures over the completeness and accuracy of expenditure and EQC review procedures. A full RCA for each audit reviewed by AQR should be completed and together with the RCA on the firm's own quality monitoring results should help establish the reasons for poor audit quality and how quality might be restored.

AQR will assess the firm's local audit quality action plan and will then determine whether any additional procedures or increased audit reviews will be required in the scope of our 2020/21 inspection programme for Grant Thornton.

VfM arrangements conclusion – all six reviews were assessed as requiring no more than limited improvement.

Firm's response:

Grant Thornton are absolutely committed to audit quality and we welcome all areas of the review work performed by the FRC. We recognise that we need to make improvements and are investing to do so. We are mindful, when performing our work, that local auditors have wider roles and responsibilities to commercial auditors, and that users of the local authority and NHS financial statements, including citizens as taxpayers and users of public services, have different priorities from corporate shareholders. We strive to bring an appropriate balance to our responsibilities under the National Audit Office Code.

We are disappointed by the FRCs findings on Property, Plant and Equipment (PPE) and take the FRCs findings seriously. Following the 2017/18 FRC inspections we implemented a Quality Investment Plan which responded to the FRCs points on PPE. Inevitably these actions – including the widespread use of external valuation experts - would not have fully impacted on the 2018/19 audits. These actions are fully implemented for 2019/20 audits. We note that there were only five other areas in which key findings were identified across six financial statements reviews. We will address all these findings in our future audit work.

We are pleased with the Value for Money results awarded by the FRC. Value for Money audit is a significant and important measure used by NHS bodies and local government to inform their own understanding of their performance.

Financial statements

We have undertaken extensive work over the past eighteen months to respond to previous comments made by the FRC and to implement our Quality Investment Plan. We have introduced a revised audit approach, enhanced training programmes, revised guidance and support for our teams, and mandated the use of auditor's experts for valuations on all major audits. This will impact fully on 2019/20 audits. It was not possible due to the timing of reviews to have these fully in place for 2018/19 audits. We will continue to drive further improvement in this area as part of our commitment to quality and to address the FRC findings.

As highlighted above, we are disappointed by the FRCs findings on PPE and take these findings seriously. Indeed the investments referred to above have focused on considerably expanding and we hope improving our work in this area of the accounts. We have prioritised our response in this way because the feedback from the FRC on individual engagements makes it clear that PPE is the major driver of our file scores. We will continue to focus on PPE, as required by accounting standards and the requirements of an ISA audit and in line with the FRC's focus in this area. Looking ahead, however, we also note the comments of Sir Tony Redmond in his recent inspection that *'valuations of non-investment properties are a potential distraction from the things that really matter to local taxpayers, notably financial resilience'*.

Whilst the recommendations of Sir Tony Redmond are not yet in force, the firm notes the significance of the Redmond review for the sector as a whole, and also notes that Sir Tony's comments in this area very much accord with the views the sector has expressed to us. Notwithstanding the commitment we have made to increase significantly the scope and nature of our work on PPE under current standards, we will therefore work with CIPFA to help it develop alternative ways that local authority accounts can be presented.

The FRC also highlighted EQCR, fraud risk factors and completeness of expenditure as its other key findings. We have summarised the FRCs findings below.

EQCR was raised as a finding on two audits. EQCRs provide a second engagement lead review on complex audits. The principle issues raised by the FRC were that the time charged did not support an effective and thorough review and that the reviewer failed to discuss significant matters with the engagement partner. We have issued revised guidance to all EQCRs.

Completeness and accuracy of expenditure was raised by the FRC on two audits and fraud risks raised on three audits. A common issue in each case was that the auditor needed to evidence better their risk assessment and conclusions. In respect of fraud the FRC highlighted the need to improve on the sufficiency of testing including sample sizes. For expenditure, the FRC highlighted the need to disaggregate debits and credits and ensure the completeness of the populations. We are addressing all these points in our ongoing training.

We will continue to develop and improve our audit approach and provide appropriate training for the other areas identified by the FRC in this year's inspections. We currently apply Root Cause analysis to all internal and external files that require significant improvement. We will ensure that we respond to any underlying issues in a systematic manner, through our Quality Investment Plan. We will also undertake a Root Cause review on all reviews. We will capture the learning from these including what went well, such as the ICAEW reviews (see appendix 2), and how we can build on this further.

Economy, efficiency and effectiveness

Under the NAO Code in place for 2019/20, auditors are required to issue a conclusion on Value for Money (VfM) at all principal authorities. The FRC reviewed six of our audits, assessing all six as Good or Limited improvement only. The ICAEW assessed all files reviewed at the top level. These are excellent results, and we are proud of the work we have delivered.

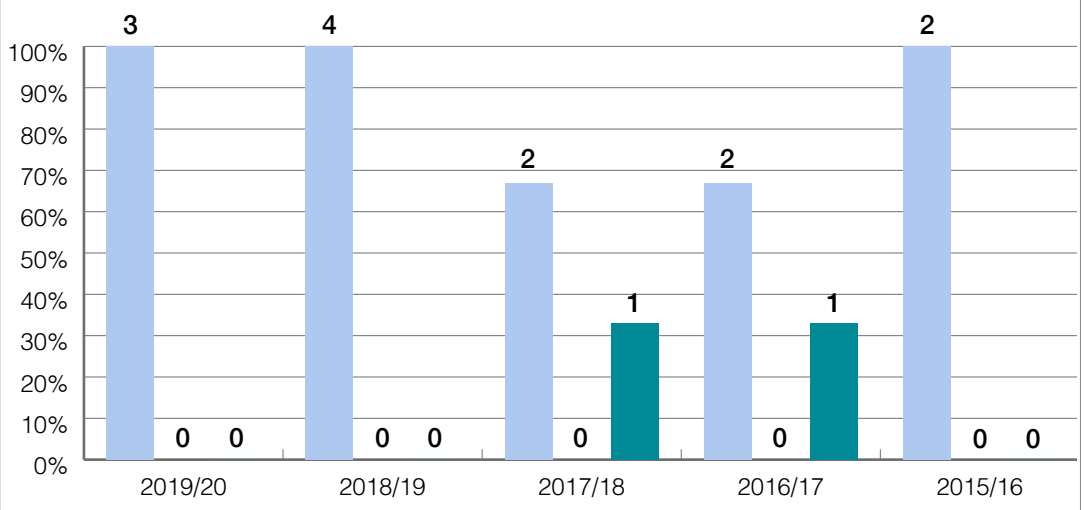
In his report of September 2020, Sir Tony Redmond, stated that: *"Audit quality is a key determinant of audit performance and this must be seen, not only as a measure against agreed standards and principles, but also whether the output of an audit is seen to meet the legitimate expectations of council taxpayers and other users of accounts….Value for money audit should be designed to provide the reader with assurance that the systems in place for use of resources in an effective and efficient way are adequate and appropriate, and that the local authority plans will deliver financial resilience in the immediate and medium term."*

We consider that VfM audit is at the centre of local audit. We take VfM work seriously, invest time and resources in getting it right, and give difficult messages where warranted. In the last year, we have issued a Report in the Public Interest at a major audit, Statutory Recommendations and Adverse VfM Conclusions.

The inspection results illustrate our strength in VfM audit, in common with other firms in the sector. With the new Code coming into effect for 2020/21, we have already updated and revised our approach. We will be training all our people in the new approach in the autumn.

Our assessment of the quality of audits reviewed

Ernst & Young LLP – financial statements audit



All audits reviewed by AQR were assessed as requiring no more than limited improvement and there were no key findings.

The firm has increased both local audit training and the rigour in its audit methodology. These actions have contributed to the improvements in the firm's quality results since 2017/18.

A number of the areas of good practice referred to in our report were from Ernst & Young LLP local audits and we have seen the firm take the lead in its use of internal specialists for both property and pension valuations.

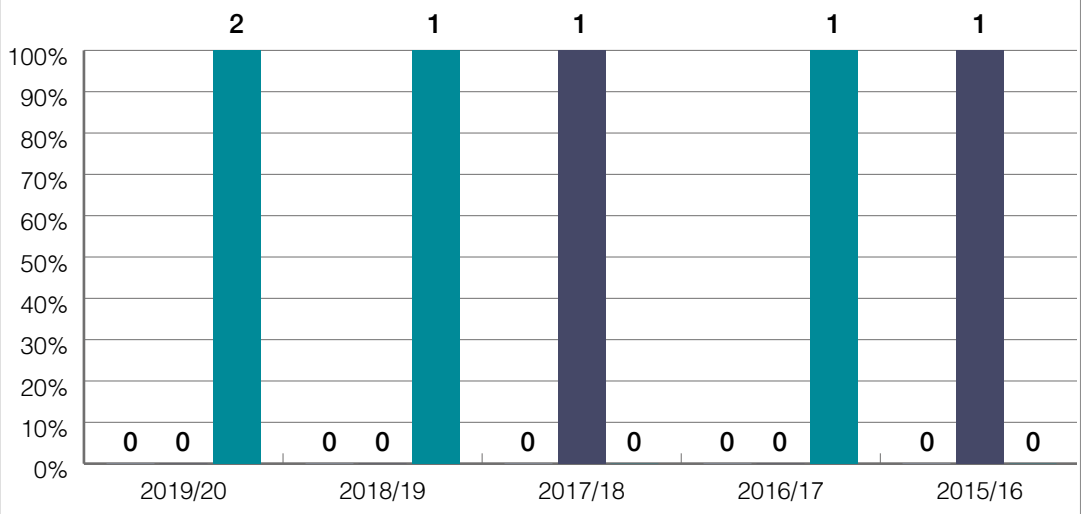
VfM arrangements conclusion – all three reviews were assessed as requiring no more than limited improvement.

Firm's response:

We are pleased with the good FRC inspection results achieved for both our financial statement opinion and value for money conclusion reviews in the last 2 years. We continue to invest in audit quality with both local training for our public sector audit teams and audit quality initiatives and training for all auditors across the UK firm. We are pleased that the changes we made to our pensions guidance to address previous inspection findings have been reflected in these results. We value the feedback received from the FRC and will ensure we respond to all findings from FRC inspections to continue to drive improvements in audit quality across the practice.

Our assessment of the quality of audits reviewed

Mazars LLP – financial statements audit



Both audits reviewed by AQR were assessed as requiring significant improvement. This is clearly unacceptable and follows a trend of poor inspection results.

Following its poor results over the past five years, the firm needs to commit to an action plan for local audit quality improvement. Key areas of quality focus for the firm include the audit of property valuations, group audit oversight, the sufficiency of audit testing over income and receivables and expenditure, and EQC review procedures. The firm should submit to AQR a full RCA for each audit and should also undertake RCA over the firm's own quality monitoring programme and the inspections performed by ICAEW to establish how audit quality can be restored.

AQR will assess the firm's local audit quality action plan and will then determine whether any additional procedures of increased audit reviews will be required in the scope of our 2020/21 inspection programme for Mazars.

VfM arrangements conclusion – both reviews were assessed as requiring no more than limited improvement.

Firm's response:

Our commitment to audit quality is at the core of our values and we are dedicated to the continuous improvement of our audit work and the service we provide to our audit clients. Whilst we are pleased with the results of the AQR's reviews of our work on Value for Money conclusions (which show only limited improvements identified for a number of years), we are disappointed with its findings on our work on the audit of the financial statements at 2 of our local audit clients. The firm will robustly respond to the findings and has plans in place to improve the quality of our local audit work.

We have prepared a Local Audit Quality Plan, which is a sector-specific element of our firm-wide Audit Quality Plan. These draw together information on risks to audit quality from a range of sources including quality monitoring findings, changes to auditing and financial reporting standards, and feedback from auditors. The Local Audit Quality Plan has also taken account of the AQR's findings and emerging audit quality risks arising from the update of Practice Note 10 and the National Audit Office's Code of Audit Practice. This plan will be maintained by the firm's Audit Quality Team and subject to oversight from our Audit Board.

Root cause analysis (RCA)

Our Audit Quality Team has undertaken a detailed RCA project to identify and understand the drivers of poor audit quality in some of our local audit work. The RCA project has focused on all local audits where the need for improvements or significant improvements have been identified either by the AQR, ICAEW or our internal Quality Monitoring Team.

A report on the findings of the RCA project was considered by our Audit Quality Board in August 2020 and our Local Audit Quality Plan will be refreshed to ensure key findings from the RCA are addressed. Our next RCA project cycle, which is due to commence in October 2020, will consider the two files reviewed by the AQR for audit years ended 31 March 2019.

Engagement Quality Control Review (EQCR)

Prior to the AQR findings, we had recognised a need to increase our capacity in relation to engagement quality control reviews. We have made investments in this area by increasing the number of individuals with detailed knowledge of local audit who are licensed to undertake this key role. We have also targeted our engagement quality control reviewer resources more effectively for the March 2020 year-end audits, focusing on those local audits that are of a significant scale, complexity, or which present additional risks to audit quality.

We recognise that our engagement quality control reviewers need a broad understanding of the particular complexities and nuances of the local government and NHS sectors, as well as emerging audit and financial issues relevant to those sectors. Therefore, from the March 2021 year-end audits, all engagement quality control reviewers who do not have significant sector expertise will attend a mandatory sector briefing, provided by the Audit Quality Team.

We have also undertaken a thematic review of our firm-wide engagement quality control review processes during 2020 in order to identify potential improvements. The report will be presented to the Audit Board in its October meeting. The findings and recommendations will help us improve the impact of our engagement quality control reviews upon audit quality.

The audit of property valuations

The nature of property valuations makes it a complex area which involves the application of a high degree of management judgement, which must be appropriately challenged by auditors. We are disappointed that the AQR has identified a need for improvements in respect of our work on property valuations.

We have developed a comprehensive suite of guidance to auditors over recent years. This has been refreshed during early 2020 to ensure that our teams are clear on the level of testing that is required in key areas such as the accuracy and completeness of source data, the challenge of management and expert judgements, and the assessment of potential risks of material misstatement arising from rolling valuation programmes. In response to the latest reviews, use of a sector-specific audit testing programme will be mandated from our 2020/21 audits onwards (having been strongly recommended for the 2019/20 audit year).

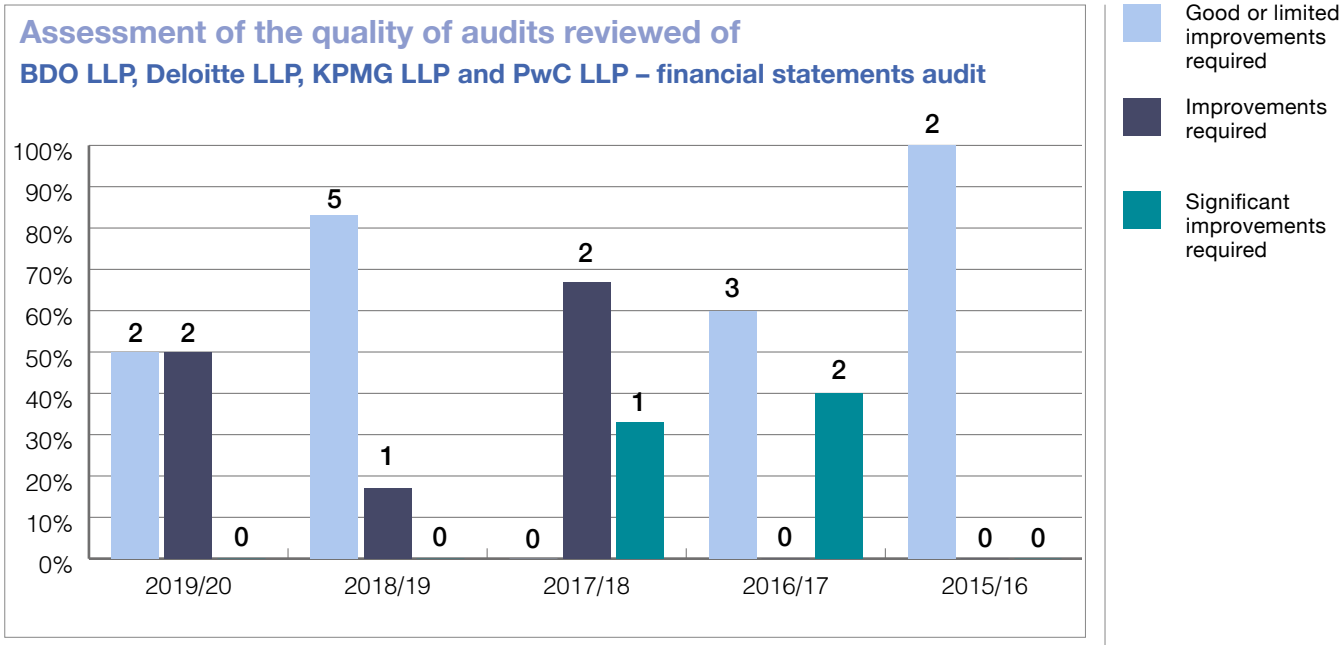
To further respond to the complexity associated with the audit of some property valuations, we have re-visited the arrangements in place for auditors to access valuations expertise to support their audit work, where required. This support is being used extensively during the audit of 2019/20 financial statements.

Group audit oversight

Our audit approach is fully compliant with underlying auditing standards. To support auditors in meeting the requirements in respect of group audit oversight, a range of mandatory templates is in place. A briefing from our Audit Quality Team to Key Audit Partners reminded them of the importance of documenting how they have exercised appropriate oversight of the group audit through, for example, their direction, supervision and review of the work of component auditors.

The audit of income and expenditure

Sector-specific briefings have reminded local auditors of the importance of fully documenting their judgements relating to the testing of income and expenditure. Such judgements include those made in determining the appropriate period before and after the year-end which should be subject to cut-off and completeness testing.



The above graph aggregates the financial statement audits reviewed for these four inspected firms. Not all of the four firms were inspected in each of the years 2015/16 to 2018/19.

With two of the audits being assessed as requiring improvement, all firms will need to consider the implications of this on their remaining audits and methodology.

All audits had AQR findings but only two had key findings. The key findings related to property valuation, completeness and accuracy of expenditure, insufficient procedures following up limitation in the work of the pension fund auditor, deficiencies in the audit work performed over payroll costs and insufficient testing of journals with higher fraud risk characteristics.

Each firm needs to consider these findings and ensure the actions committed to are completed, such as increased training, changes to methodology or mandated procedures/ testing. The two firms with audits requiring improvement should submit a full RCA to AQR. All firms need to consider the results from their internal monitoring and of inspections performed by ICAEW to establish if there are any other areas of concern.

AQR will assess the two firms' local audit quality action plans and will then determine whether any additional procedures or increased audit reviews will be required in the scope of our 2020/21 inspection programme.

VfM arrangements conclusion – each firms' review was assessed as requiring no more than limited improvement.

Firm's response:

BDO

The key findings reported relate to similar issues that have been reported over a number of recent years. Our audit approach and supporting training, both general and sector specific, for all of our teams, over the last few years has included focus on further enhancements to our work on valuations, pensions, the completeness of expenditure and our testing of journals. This includes issuing guidance on identified best practice in challenging of property valuations, revisiting and developing our pensions auditor assurance scope and further enhancing data analytics scope and functionality.

Deloitte

Audit Quality is our number one priority. We welcome the challenge provided by the AQR inspections and thank them for their insight and comments. We perform root cause analysis on all our external AQR inspections and take actions to address any matters identified and to share best practice. We note the areas of findings highlighted by the AQR and we have taken wider actions within our audit practice to address these. This includes enhanced training and guidance on reporting from specialists (for example property) and updated risk assessment guidance for pensions assets supported by our Pensions Centre of Excellence. In addition, we share all inspection findings as part of training to staff involved and to our internal quality reviewers.

KPMG

We have strengthened the foundations of audit quality as a result of our significant investment over the past three years. Our focus is on achieving consistent application of our new procedures. We have completed root cause analysis over any AQR findings in this cycle and will continue to invest to maintain a standard of audit rightly expected by the AQR. Further investment is planned for 2020 to help ensure this.

PwC

Our Programme to Enhance Audit Quality (PEAQ) was launched in June 2019. This three year programme includes a wide-ranging and fundamental package of measures, with the single objective of delivering consistently high quality audits. We have made significant progress since the start of the programme and remain committed to continued focus and investment in this programme over the next two years.

We have a limited number of Local Audit engagements, which are all performed by Responsible Individuals with a significant focus on this industry specialism within their portfolios. During 2019/20, a sample of our Local Audits was inspected by the AQR and through our own internal quality monitoring programme.

As set out in our response to the AQR's July 2020 inspection report on the firm, as part of the PEAQ a revised approach to root cause analysis (RCA) was approved by the Audit Executive in February 2020. In July 2020, we created a dedicated team specialising in Continuous Improvement activities across inspection, review and other audit quality activities. This team performs RCA on identified issues and prepares an action plan to address those findings, using intelligence from both audit quality findings and best practice examples. The nature of the findings raised in this report across all firms was discussed with the inspection team earlier this year and was shared with our Local Audit RIs as part of our continuous improvement activities.

3 Other matters

FRC engagement with annually inspected firms and other stakeholders to improve audit quality

We have increased engagement with Government Departments and other key Local Audit and Accountability Act 2014 ("LAAA") stakeholders during 2019/20, to ensure an awareness of the risks in the sector and that risks and audit quality matters are communicated back to stakeholders. These discussions and meetings with stakeholders have included NAO, CIPFA, ICAEW and PSAA, together with participation in Ministry of Housing, Communities and Local Government (MHCLG) Delivery Board meetings.

The Local Audit Sub-Group, chaired by the FRC to deal with audit related issues arising from the new regime, met once in 2019. The MHCLG commenced formal meetings during 2019 on Local Audit matters and this has effectively replaced the Sub-Group.

The MHCLG Local Audit Delivery Board has met quarterly and the FRC has been represented at all meetings. The FRC has two members on the delivery Board, one from the Professional Oversight Team and one from AQR. Other members of the Board comprise key stakeholders responsible for delivery of aspects of the Local Audit and Accountability Act 2014 (the Act), such as the National Audit Office (setters of the Audit Code for Local Auditors), CIPFA (responsible for the Accounting Code), PSAA (selected by most local government bodies to appoint auditors and negotiate audit fees on their behalf; formerly responsible for monitoring audit quality) and the Local Government Association.

Registered audit firms conducting local audits are not permitted on the Board. At an audit firm level, the FRC has continued regular engagement with all seven firms conducting major local audits. This has included planning meetings before scoping the 2019/20 inspection cycle and regular updates during the inspection process. We have met all firms to discuss the initial audit quality findings ahead of the 31 March 2020 year end for Local Audit bodies to ensure firms can develop their own plans to improve quality on those areas of concern. Discussions with the firms continue in the wake of sector-specific matters following the COVID pandemic.

Developments in Local Audit

At the end of 2019, MHCLG announced that Sir Tony Redmond (former CIPFA President) would conduct a review of local authority financial reporting and external audit (the Redmond Review).

The Redmond Review was extended beyond a post-implementation review to consider the quality of the audit of local authorities, whether auditors were using their reporting powers correctly and if councils were heeding recommendations to help improve the financial management of their accounts.

One key purpose of the Review was to consider the structure and oversight arrangements for Local Audit and, consistent with the recommendations of the Kingman review, whether a single body should be created to oversee Local Audit. The recommendations arising from this review were published on 8 September 2020 (https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review)

Appendix 1: Key local audit information

Identifying major local audits

An analysis of available local audit data for 2019 identified 271 major local audits within AQR scope. This number changes annually as the definition of a major local audit is dependent upon meeting one of the following criteria:

- Total income or expenditure of at least £500 million; or
- For a Local Authority pension scheme, at least 20,000 members or gross assets in excess of £1,000 million.

The following table sets out the total number of Local Audits by sector, along with those assessed as meeting the major local audit definition. The audits for Local Government and other non-health bodies were principally awarded to five audit firms in five tiered tranches, following a full tender process conducted by PSAA in its capacity as an appointing person under the LAAA. These audit appointments were made to cover five accounting periods commencing with 31 March 2019. The table also sets out the number of major local audits subject to audit inspection by AQR.

No Local Authority pension fund audits were selected for review in 2019/20, but pensions accounting, and its associated disclosure were selected as an area of focus in 11 of our 12 non-health reviews completed. Furthermore, AQR has previously reviewed a sample of Local Authority pension fund audits, without significant findings. We are planning to select some pension fund audits as part of our 2020/21 inspections programme.

Category	Total Population	Major Local Audits	Reviewed by AQR in 2019/20
Health Bodies (NHS Trusts and Clinical Commissioning Groups)	286	63	3
Local Government Bodies	361	130	10
Police and Crime Commissioners (PCC)	74	9	1
Other Bodies (inc fire and waste)	59	3	1
Local Authority Pension Funds	80	66	0
Total	**860**	**271**	**15**

Audit firms completing local audits

There were seven audit firms that completed at least one audit of a major local body for the financial year ended 31 March 2019. The three firms with the largest market share of major local audits were Grant Thornton, EY and Mazars, with a collective share of 82%. All the firms involved, including the number of audits they completed, and their respective market shares were as follows:

Audit firm	Number of Local Audits	Market Share %	Number of Major Local Audits	Market Share %	Reviewed by AQR in 2019/20
Grant Thornton UK LLP	323	37.6%	109	40.2%	6
Ernst & Young LLP	222	25.8%	72	26.6%	3
Mazars LLP	111	12.9%	42	15.5%	2
KPMG LLP	109	12.7%	25	9.2%	1
BDO LLP	55	6.4%	12	4.4%	1
Deloitte LLP	36	4.2%	10	3.7%	1
PwC LLP	4	0.4%	1	0.4%	1
Total	**860**		**271**		**15**

Appendix 2: Firms' internal quality monitoring and ICAEW results

Results of Firms' own monitoring

Background

This appendix sets out aggregated information relating to the seven firms' internal quality monitoring for individual audit engagements. It should be read in conjunction with each firm's transparency report, which provides further detail of the internal quality monitoring approaches and results, and the firm's wider system of quality control. We consider that publication of these results provides a fuller understanding of quality monitoring in addition to our regulatory inspections, but we have not verified the accuracy or appropriateness of these results.

Due to differences in how inspections are performed and rated, the results of the firms' internal quality monitoring may differ from those of external regulatory inspections and should not be treated as being directly comparable to the results of other firms.

Firms approach to internal quality monitoring

The firms' internal inspection programs generally consider the full population of both major and non- major local audits performed. The programs are varied but are usually risk-based as well as structured to cover Responsible Individuals ("RIs") over a fixed period of time. Audit files are selected for review based on a number of criteria, including risk and public interest. Reviews are supervised and reviewed by the firms' own internal quality teams.

Scope

The seven firms' Internal Quality Monitoring ("IQM") program, relating to local audit, covered 29 individual audits, of which 12 related to major local audits.

The aggregate number of major local audits covered by the firms' own IQM was less than that of the AQR and amounted to:

Coverage of all local audits 3.4%

Coverage of major local audits 4.4%

Furthermore, not all firms reviewed the VfM arrangements conclusion work on each audit selected for review.

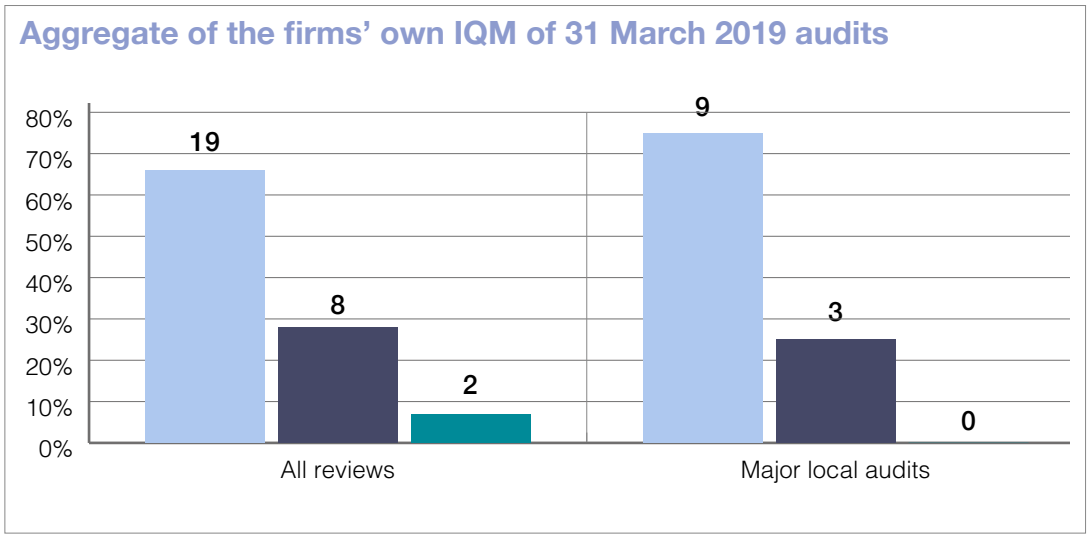
One firm did not select any local audit files for review.

Results

In aggregate, the firms reported that across the 29 local audits reviewed, 19 (65.5%) were of a good standard or limited improvement standard. There were eight audits assessed as requiring improvement and two audits needing significant improvement.

For the firms' major local audits, 12 were reviewed and nine (75%) were assessed as either good or requiring limited improvement and there were no audits assessed as requiring significant improvement.

The results of the firms' financial statement opinion reviews for 31 March 2019 local audits are set out below.



The firms' various IQM programs generally use the same grading categories as AQR but where this is not the case, decisions on grading are aligned as closely as possible to those that would result from the AQR process.

Results of ICAEW monitoring

Background

All firms completing local audits are subject to annual independent monitoring by ICAEW. ICAEW reviews local audits outside the FRC's population. ICAEW does not undertake work on the firms' firm-wide controls as it places reliance on the work performed by the FRC.

Scope

ICAEW's reviews are risk-based, with the aim of reviewing a representative sample of a firm's local audit portfolio over a six year cycle. ICAEW adopts a cyclical approach to the monitoring of registered local auditors. Audit monitoring under the Local Audit and Accountability Act 2014 had a phased implementation. In the first year, the scope of monitoring was limited to a firm's portfolio of local health body audits of years ended 31 March 2018. In this, the second year, the scope of monitoring was extended to include local audits (health and local government bodies) of years ended 31 March 2019.

ICAEW reviews are designed to form an overall view of the quality of the audit. Where applicable, both the financial statement opinion audit and work to support the VfM conclusion are reviewed. ICAEW assesses the audits it reviews as either 'satisfactory/ acceptable', 'improvement required' or 'significant improvement required'. Visit icaew.com/auditguidance for further information about ICAEW's audit monitoring process including its approach to assessing audits.

In 2019/20 ICAEW planned to review 14 standard-scope engagements, but because of sector-wide challenges, some audits of years ended 31 March 2019 were unavailable for review during this review cycle. Reviews of at least two of these audit opinions will be deferred until 2020/21.

ICAEW has completed its 2019/20 monitoring and the report summarising its audit file review findings and any follow-up actions proposed by the two firms that were inspected (GT and EY) will be considered by ICAEW's audit registration committee in November 2020.

Results

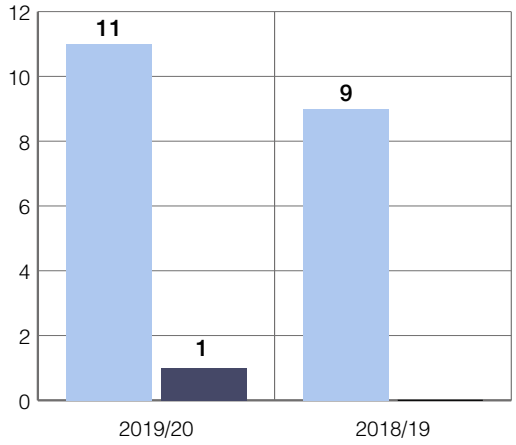
The audit work reviewed for 2019/20 was generally of a good standard. 11 reviews were satisfactory/acceptable, with one requiring improvement. The work to support the VFM conclusion was satisfactory on all files reviewed.

ICAEW assessed one audit as needing improvement due to weak substantive analytical review of pension scheme assets. Other findings included weaknesses in audit testing of Property, Plant and Equipment in four audits, and other isolated aspects of audit evidence and documentation.

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.

Results of ICAEW's financial statement opinion reviews for the last two years are set out below.

ICAEW assessment of the quality of non-major audits reviewed



Satisfactory/ acceptable

Improvements required

Significant improvements required

Given the sample sizes, number of audit firms reviewed and mix of local audit bodies inspected changes from one year to the next, the proportion of audits falling within each category cannot be relied upon to provide a complete picture of the firms' aggregate performance or overall change in audit quality.

Firm's response:

GT

For 2018/19, the ICAEW selected seven of our audits for review of the financial statements audit. Of these, six audits were assessed as satisfactory/acceptable. Only one audit had improvements required, and we have already taken action to address the issues raised. The ICAEW also reviewed five Value for Money Conclusions. All five were assessed as satisfactory/acceptable. We are delighted with the results, which in our opinion evidence the hard work and investment we have made in audit quality in recent years. As reflected elsewhere in this report, these efforts are yet to significantly impact our AQR scores to the levels expected by the FRC and we will continue to work hard to ensure that our efforts more clearly translate to improved AQR scores in future. We are undertaking Root Cause reviews to identify what we got right, and any scope for further improvement.

The firm's internal monitoring showed similar results to the ICAEW reviews. Of eight local audit files selected, seven had good or limited improvements. Only one file had improvements required and we have now completed the Root Cause review and identified and responded to all learning points. Four of the five Value for Money files selected showed Good or limited improvements required, and only one had improvements required. As above, we are capturing the learning and will build on this for 2019/20 and beyond.

EY

We are pleased with the good results achieved in EY's ICAEW quality assessments, achieving 100% satisfactory/acceptable in both the 19/20 and 18/19 inspections. This reflects the results of our internal inspections of health and local government audits performed in September 2019, our 2020 public sector internal inspections are scheduled for September 2020.

We continue to invest in audit quality with both local training for our public sector audit teams and audit quality initiatives and training for all auditors in the UK firm. We welcome feedback from our regulators and the lessons learnt from both internal and external inspections will be included in upcoming training for public sector auditors.

Mazars

We operate a robust quality monitoring review programme which mirrors the challenge shown by the AQR in its reviews of audit quality. We are proud of an uncompromising approach to quality monitoring as a key part in driving improvements in audit quality.

Our quality monitoring arrangements for local audit work form an integrated part of our firm-wide programme for review, overseen by our Director of Audit Standards. The local audit work of all of our Key Audit Partners is reviewed at least every two years as part of this programme. These reviews cover the work undertaken on both the audit of the financial statements and the conclusion on Value for Money arrangements. Our quality monitoring programme for 2018/19 audits included reviews of 9 (7.7%) local audit files. Of these, 5 (11.1%) were reviews of major local audits.

Findings from quality monitoring reviews, together with responses to the key themes and findings from our Audit Quality Team, are reported three times a year to the Audit Board alongside the key findings from our root cause analysis projects. The frequency of reporting means that responses can be put in place quickly to address significant findings at a firm-wide level, where required.

BDO

In relation to the results of the ICAEW reviews of non-major audits we consider that given the small sample size and the fact that all firms are not reviewed annually, caution should be exercised in drawing overall conclusions on any trends.

In relation to the overall firms' IQM results again comparisons can be difficult given that the approach to internal reviews across all firms varies. We would note that in relation to our internal review results, we use root cause analysis where appropriate to determine the causes of any points raised and to drive actions undertaken across the sector.

Our audit approach and supporting training, both general and sector specific, for all of our teams, over the last few years has included focus on further enhancements to our work on valuations, pensions, the completeness of expenditure and our testing of journals. This includes issuing guidance on identified best practice in challenging property valuations, revisiting and developing our pensions auditor assurance scope and further enhancing data analytics scope and functionality.

Deloitte

The firm includes both major local audits and local audits within our annual IQM processes. The selections are risk based and ensure that there is coverage of all responsible individuals over a three year period for local audit work. The firm undertakes Root Cause Analysis ("RCA") for any improvement required or non-compliant engagement inspections, as well as on positive results to identify factors to support audit quality. The firm performs retrospective remediation of all high and medium findings, and prospective remediation on all findings in the subsequent year's audit. We communicate any thematic findings from engagement reviews to the practice. Further information on our IQM processes can be found within our annual transparency report.

KPMG

Our QPR programme for local audit mirrors that of our wider audit practice and is designed to hold audit teams to quality levels that assess not only compliance with auditing standards but also adherence to internal requirements such as the performance of specified procedures or completion of specific mandated consultations. As such teams that perform audits that are very substantially compliant with auditing standards may receive a rating other than satisfactory in our internal reviews. Accordingly, it is difficult to make direct comparisons between the results of our internal and external inspection processes.

In order that we learn from the internal and external inspections process we perform root cause analysis to consider the details of findings from across the full spectrum of reviews to identify remedial actions. We also consider findings from a range of inspections to ensure that we develop robust remedial actions. We have a series of actions in place focussed on enhancing our coaching, reviewing and project management capabilities. We have also continued to expand our Second Line of Defence team.

PwC

As set out in our response to section 2, we have a limited number of Local Audit engagements, which are performed by Responsible Individuals with a significant focus on this industry specialism within their portfolios. During 2019/20, a sample of the firm's local audits was inspected through our own internal quality monitoring programme – the Engagement Compliance Review (ECR).

As set out in our response to the AQR's July 2020 inspection report on the firm, our ECR programme considers the full population of audits performed and is designed to cover both the firm's responsible individuals ("RIs") and specific categories of audit clients, including Local Audit. Our ECR programme involves a post-signing review of an audit engagement for each RI at least once every three years, and twice in any six-year period for audits identified by the firm as having a high public profile. Findings and best practice examples from any ICAEW inspections and ECR reviews are incorporated into our continuous improvement programme.

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