EY — Building a better working world

Financial Reporting Council (FRC) report on the inspection results of major local audit

On 30 October 2020 the FRC published for the first time the results of inspection of local audit, i.e. the work that auditors do on local government and NHS entities like yourselves under the NAO Code. We were very pleased that the three EY audits they reviewed were rated as good or only needed limited improvements (for the second year running), which compares extremely favourably to the other providers in this market. The results support the efforts we have made in focusing on audit quality and the investments in training and developing our audit methodology, including the use of specialists such as internal valuers and our attention to asset valuations which is highlighted as an example of good practice.

A link to the report is here - **(LINK).**

Summary: Findings from the FRC's inspection of major local audits in England, for the financial year ended 31 March 2019, were published on Friday last week. The FRC explains that its report focuses on the key areas local audit activity requiring action from across the firms. The FRC's primary aim is to safeguard and enhance the quality of local audits.

Of the 271 major local audits in the FRC's inspection scope, the FRC reviewed 15 across the seven largest audit firms, covering both the financial statement opinion and the Value for Money (VfM) arrangements. For the financial statement opinion two audits reviewed by the FRC required significant improvements and seven required improvements. None of the VfM conclusions reviewed required more than limited improvement.

FRC states that 'some firms are still not consistently achieving the necessary level of audit quality and therefore need to make further progress.' For two firms, Grant Thornton and Mazars, the level of audit quality requires significant improvement, and those firms should perform a detailed Root Cause Analysis (RCA) of the issues the FRC has identified and put in place, with an audit quality action plan across local audits to address the FRC's findings.
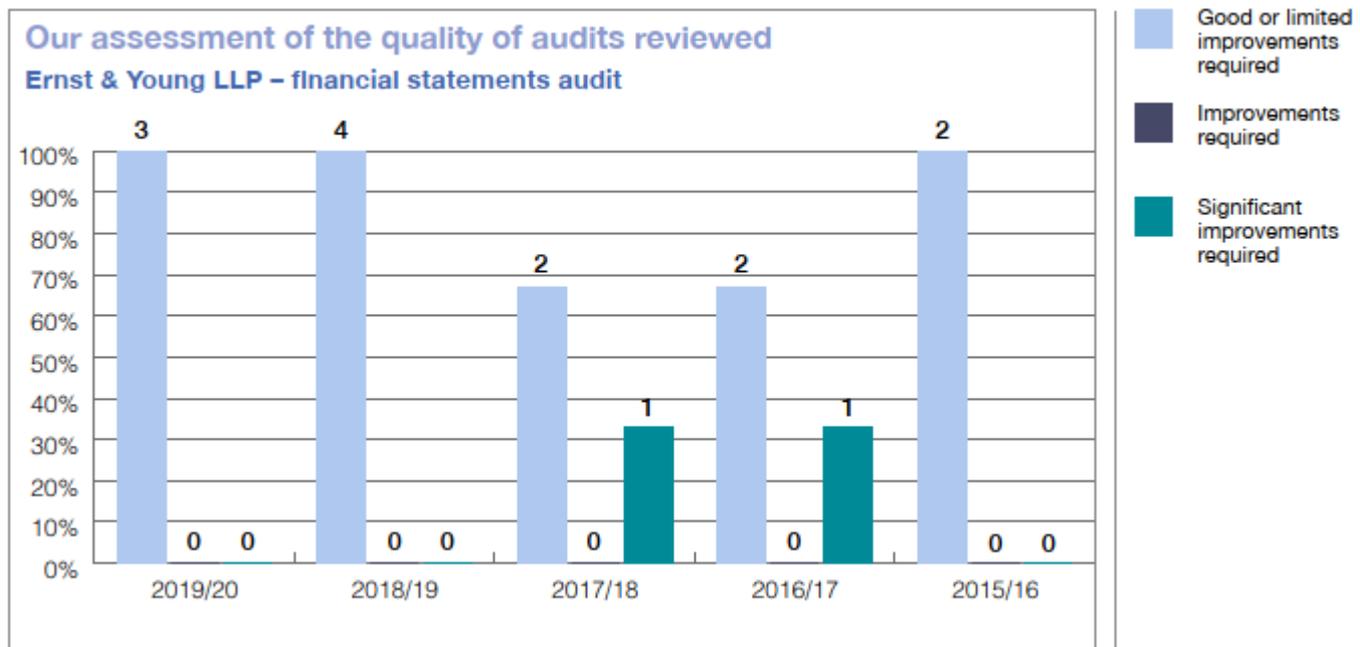
The key areas of concern requiring action by some audit firms are as follows:

- the valuation of property (including investment property);
- sufficiency of audit procedures over the occurrence and completeness of expenditure;
- the response to fraud risks;
- the impairment of receivables;
- valuation of pension assets; and
- the effectiveness of the Engagement Quality Control review.

Financial statements audit – review trends

All reviews – for the seven firms inspected

	2019/20	2018/19	2017/18	2016/17	2015/16
Good or limited improvements required	6	9	3	7	5
Improvements required	7	3	4	1	2
Significant improvements required	2	2	3	4	1

EY results

Our assessment of the quality of audits reviewed
Ernst & Young LLP – financial statements audit

	2019/20	2018/19	2017/18	2016/17	2015/16
Good or limited improvements required	3	4	2	2	2
Improvements required	0	0	0	0	0
Significant improvements required	0	0	1	1	0

END

Reflections from the Redmond review

Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting

Published on the 8th September 2020, Sir Tony Redmond's findings and recommendations from his independent review provides a significant opportunity to shape the future sustainability of local government financial reporting and auditing. We believe this will help ensure audit continues to meet the evolving needs of local authorities, the public, and the public interest.

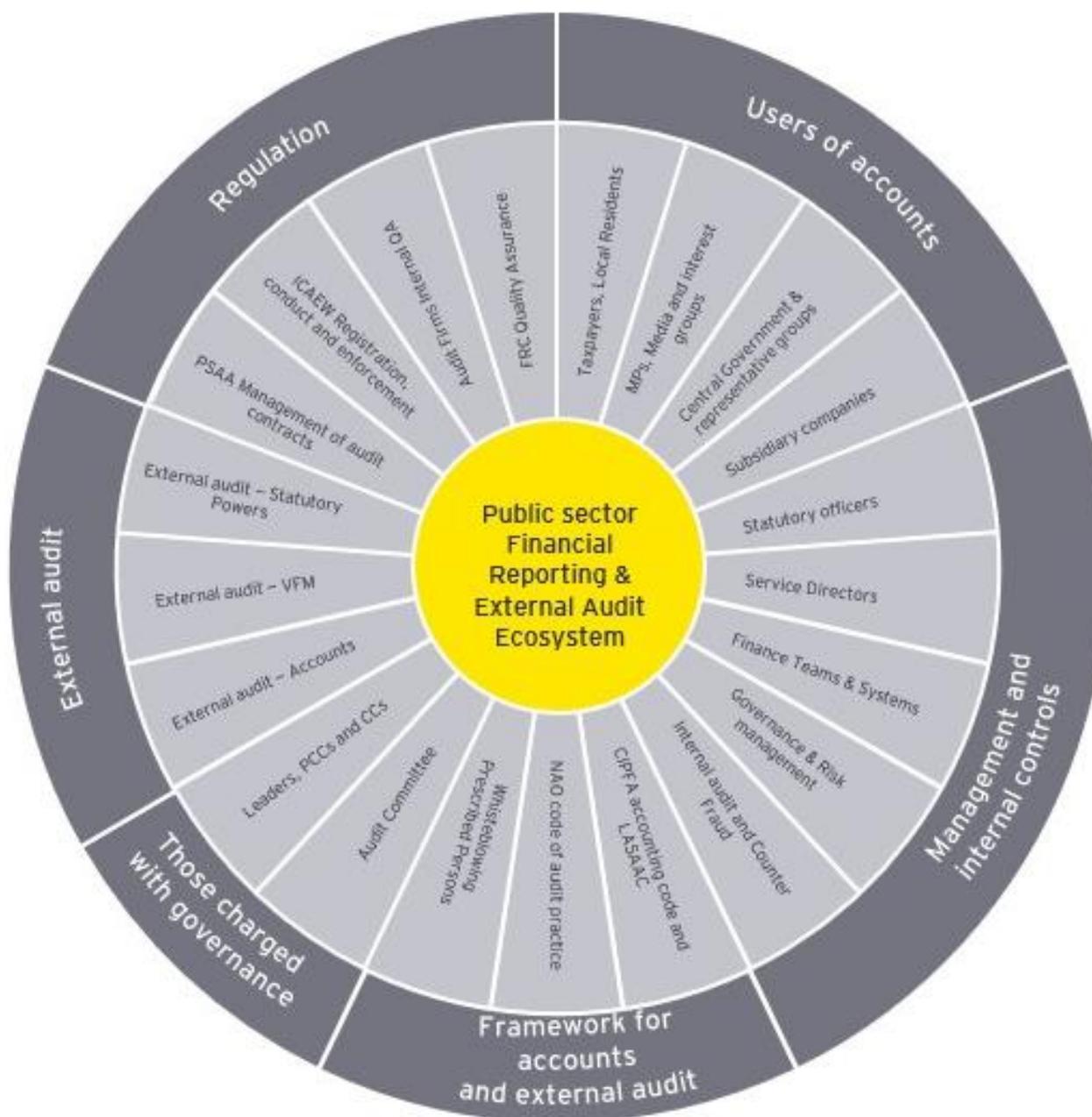### Guiding principles for reform

We believe reforms should be guided by the following principles:

- Reforms should enhance, or at least should not create risks to, the quality of financial reporting and external audit.
- The importance of the multidisciplinary audit firm model, to enable local auditors to respond efficiently and effectively to the increased reporting complexity, risks and financial resilience pressures we have seen facing the public sector pre and post Covid-19.
- There should not be a two-tier system of generally accepted accounting and auditing standards between the public and corporate sectors.
- To be effective and sustainable, reforms need to focus on the public sector financial reporting and external audit ecosystem as a whole.

What impact will the Redmond review have on Cambridge City Council?

- The proposed Office for Local Audit Regulation (OLAR), aimed to be a "system leader", will apply to the Council's external auditor. The transition from the current arrangements to OLAR may increase audit requirements.

- The publishing deadline for accounts is recommended to be 30 September.

- All stakeholders in the ecosystem have a role to play to improve accountability, transparency and sustainability of financial reporting. In particular, improving the effectiveness of Audit Committees, strengthening the training skills, capacity, capability and the attractiveness of public sector finance and audit professions.

- The review highlights the importance of the auditors work to critically assess the financial resilience and viability of public sector bodies and has proposals on how this assessment could be enhanced within the NAO's code of audit practice. This may lead to a change to how auditors consider financial resilience.

- Changes to how you account for and report on your property, plant and equipment and pension liability will require CIPFA to change its Code and may take some time.

- You may be required to prepare a 'standardised statement of service information and costs' which can be compared with the budget agreed to support the council tax/precept/levy and presented alongside the accounts.

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Public sector Financial Reporting & External Audit Ecosystem

Regulation
- FRC Quality Assurance
- Audit firms internal QA
- ICAEW Registration, conduct and enforcement
- PSAA Management of audit contracts

Users of accounts
- Taxpayers, Local Residents
- MPs, Media and interest groups
- Central Government & representative groups
- Subsidiary companies
- Statutory officers

External audit
- External audit – Statutory Powers
- External audit – VFM
- External audit – Accounts

Management and internal controls
- Service Directors
- Finance Teams & Systems
- Governance & Risk management
- Internal audit and Counter Fraud

Those charged with governance
- Leaders, PCCs and CCs
- Audit Committee
- Whistleblowing Prescribed Persons

Framework for accounts and external audit
- NAO code of audit practice
- CIPFA accounting code and LASAAC

Taking our guiding principles, we broadly welcome the Redmond review and proposals, in particular:

Quality of financial reporting and external audit

- The recognition that all stakeholders in the ecosystem have a role to play to improve accountability, transparency and sustainability. This includes improving the effectiveness of Audit Committees, strengthening the training skills, capacity capability and attractiveness of the public sector finance and audit professions.

- His conclusion that the current procurement and fee structure does not support sustainable audit quality. We have provided you with our perspectives on how baseline audit fees need to change to take account of your risk profile, complexity as well as the regulatory and professional context which drive our audits.

Reforming the public sector financial reporting and external audit ecosystem

- Establishing the Office for Local Audit Regulation (OLAR), which provides a "system leader" and will bring clarity to the existing framework for local authority audit.

- The importance of MHCLG establishing a liaison committee of all key stakeholders to oversee reforms. To begin with MHCLG should take urgent action to implement primary legislation to establish OLAR, revise the timetable for financial reporting and revisit the procurement and fee structure for public sector audit.

Multidisciplinary audit firm model

- The importance of the auditors work to critically assess the financial resilience and viability of public sector bodies and his proposals on how this assessment could be enhanced within the NAOs code of audit practice.

Safeguarding professional accounting and auditing standards

- The need for CIPFA/LASAAC to revisit the accounting code and introduce summarised accounts. We agree that there is a need for more proportionality in the Code which also sets out the expectations of practitioners and auditors and how this could be applied in areas such as pensions and asset valuations. However, we believe that any future proposals on the accounting code should not create a two-tier system.

What are we doing in the meantime?

- Planning for a 30 September financial reporting target date for local government 2020/2021 accounts, integrated with our NHS work.

- Implementing the new NAO code and changes to our VFM conclusion work and reporting for 2020/2021 audits. We will also work with the NAO and other audit suppliers on any refinements to how auditors assess financial resilience.

- Continuing to engage with and influence MHCLG, NAO, PSAA CIPFA/LASAAC, FRC and other key stakeholders on the actions required to implement the Redmond proposals as swiftly as possible and how these effectively align to the broader package of audit reforms which BIES will consult on later this year.

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