

# Audit Practice Annual Quality Report

Corporate report

November 2009



**audit**  
commission

**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.**

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# Contents

<b>Introduction</b>	<b>3</b>
<b>The Audit Commission's audit practice</b>	<b>4</b>
<b>The Commission's approach to audit quality</b>	<b>9</b>
<b>Results of our 2007/08 quality monitoring programme</b>	<b>17</b>
<b>Results of external quality reviews</b>	<b>22</b>
<b>Our commitment to audit quality</b>	<b>26</b>
<b>Appendix 1 – Financial Reporting Council's audit quality framework</b>	<b>27</b>

# Introduction

- 1 The Audit Commission's in-house audit practice (the audit practice) is the fifth largest in the UK and the bodies we audit are inherently public interest entities. As a public audit agency we need to be able to provide assurance to our audit clients, government and other stakeholders, and the public that the audit work our audit practice delivers is of an appropriate quality.
- 2 We therefore believe it is right that we should publish an annual report giving information on the audit practice, including on its structure and governance and on its systems for ensuring audit quality.<sup>1</sup> We believe that publishing this report:
  - demonstrates our unequivocal commitment to delivering audit quality;
  - provides assurance to audited bodies and key external stakeholders about both the arrangements we have put in place to ensure audit quality and the underlying strength of the Commission's audit practice; and
  - enables them to compare our audit practice with the firms and other audit agencies.
- 3 This is our third annual report. It provides an overview of the system of quality control, quality monitoring and quality review that we have put in place, and puts into the public domain information about the results of our internal quality monitoring programme and of quality reviews of our work by external inspectors.
- 4 The report demonstrates that the Audit Commission operates a formal and well-defined framework to promote, deliver and assess audit quality. Based on my assessment of the adequacy of the framework, and the findings of the quality monitoring and quality review programmes, I remain satisfied with the effectiveness of the functioning of the internal quality control system operated within the practice. Notwithstanding this conclusion, I and the other members of the senior management team within the Audit Commission remain focused on addressing the areas for improvement identified through internal and external review.

Martin Evans  
Managing Director, Audit

October 2009

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<sup>1</sup> Under Article 40 of the revised European Eighth Company Law Directive, auditors of listed companies have a statutory obligation to produce an annual transparency report giving equivalent information about the firm. All of the private sector audit firms in the Commission's audit regime are subject to the new statutory requirement from April 2008. These requirements were introduced by regulations issued by the Professional Oversight Board of the Financial Reporting Council in The Statutory Auditors (Transparency) Instrument 2008 (POB 01/2008) in April 2008. Although the Commission's audit practice is not covered by the new statutory requirement, we have decided to comply with it on a voluntary basis.

# The Audit Commission's audit practice

## Background

- 5 The Commission's audit practice is the successor to the District Audit Service which was first established in 1844 and was absorbed into the Audit Commission when it was set up in 1983. It retained its separate brand name until 2002.
- 6 Under the Audit Commission Act 1998, the Commission's core statutory responsibility is to appoint auditors to local government and NHS bodies in England and Wales.<sup>1</sup> It may appoint appropriately qualified officers of the Commission or firms of accountants. Currently, it appoints officers of the Commission, organised into the Commission's audit practice, to some 70 per cent of the audits within its regime. Under the Charities Act 1993 (as amended) the Commission also appoints auditors to English NHS charities and the audit practice undertakes the audit of the majority of these.
- 7 In addition, officers of the Commission may – with the approval of the Commission – be appointed as the auditor of foundation trusts under the National Health Service Act 2006.
- 8 In 2008/09, the audit practice was the appointed auditor to 580 principal bodies and some 2,500 small bodies (charities, parish and town councils and internal drainage boards).

**Table 1**

Type of body	Number
County councils	24
Unitary authorities	59
London boroughs	20
District councils	162
Police authorities	32
Fire and rescue authorities	27
Probation boards	29
Strategic health authorities	10
NHS trusts	89

<sup>1</sup> For further information about the Commission and its other functions please go to [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

## The Audit Commission's audit practice

Type of body	Number
Primary care trusts	106
Other	22

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- 9 Details of these appointments are published in the Audit Commission's annual Directory of Audit Appointments, which can be found at [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)
- 10 The audit practice is also the appointed auditor to 50 NHS foundation trusts (as at 31 March 2009). These are also listed on the Audit Commission website at [www.audit-commission.gov.uk/health/trustpractice/Pages/ouraudits.aspx](http://www.audit-commission.gov.uk/health/trustpractice/Pages/ouraudits.aspx)
- 11 The audit practice's gross fee income from these audits in 2007/08 was £125 million. This makes it the fifth largest audit practice in the UK. The Audit Commission is not a profit-making body and there is no planned surplus.
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**Table 2**

Turnover arising from:	2008/09 £ million	2007/08 £ million	2006/07 £ million
Audit	110	106.9	100.6
Certification of claims and returns	13	13.8	15.9
Non-audit work (advice and assistance or section 35) <sup>1</sup>	2.2	0.8	1.1
Total turnover	125.2	121.5	117.6

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<sup>1</sup> In addition to its statutory audit and inspection responsibilities the Commission also has powers to perform advice and assistance work. The Local Government and Public Involvement in Health Act 2007 (which amends the Audit Commission Act 1998) provides the Audit Commission with a power to provide advice to and assist public bodies in the United Kingdom and abroad, as well as registered social landlords, and to charge for the service provided. These powers replace the powers under section 35 of the Audit Commission Act 1998.

12 Some 1,300 staff work in the audit practice, made up as follows (as at 31 March 2009).

**Table 3**

	Number	Per cent	Number qualified	Per cent
Senior management	27	2	20	74
District auditors*	57	5	57	100
Senior audit managers*	14	1	14	100
Audit managers	274	22	260	95
Auditors or principal auditors	417	34	302	72
Trainees	136	11	N/A	N/A
Performance manager or specialists	300	25	35	12
<b>Total</b>	<b>1,225</b>	<b>100</b>	<b>688</b>	<b>56</b>

\*By law, individuals appointed as auditors must hold a professional accountancy qualification.

- 13 The audit practice has the characteristics of a major audit firm. As described in this report, it complies with the same professional standards and has a similar professional infrastructure.
- 14 However, it is distinctive in that it is exclusively a public sector audit practice. One of the defining characteristics of public audit (as defined by the Public Audit Forum)<sup>1</sup> is its wider scope, which extends beyond giving a true and fair (or presents fairly) opinion on the financial statements to include considerations of legality (regularity), probity (or propriety) and value for money. As such, public audit is an essential element in the process of accountability for public money, and makes an important contribution to the stewardship of public resources and the corporate governance of public services.
- 15 The Commission's audit practice aims to deliver world-class public sector audits, consistently and efficiently, in compliance with professional and regulatory requirements, so as to secure impact and to serve the public interest.

## Governance and structure

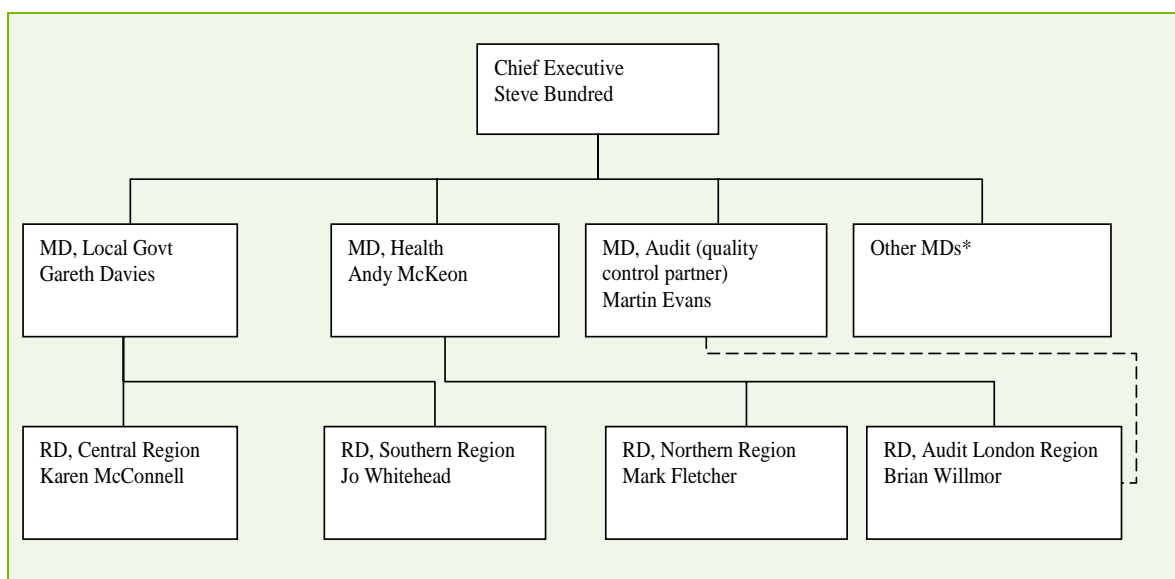
- 16 The Commission's audit practice is an integral part of the Audit Commission and is thus governed by the Commission Board which comprises independent, non-executive members (Commissioners), appointed by the Secretary of State.

<sup>1</sup> The Public Audit Forum is a consultative and advisory group which comprises the five public audit agencies in the UK and provides a focus for development thinking in relation to public audit.

## The Audit Commission's audit practice

- 17 The audit practice is led by the Audit Commission's Chief Executive (Steve Bundred), supported by a management team comprising the Commission's managing directors. The managing directors for Health (Andy McKeon) and Local Government (Gareth Davies) are responsible for all aspects of operational delivery. The managing director, Audit (Martin Evans) is responsible for all professional issues, including the audit approach, technical support, training and the ethical framework. He is the audit practice's quality partner in accordance with the Auditing Practices Board's International Standard on Quality Control (UK and Ireland) 1 (ISQC (UK&I)1).
- 18 The audit practice is organised functionally into a general practice, which is responsible for the audits of all local government bodies, NHS primary care trusts, strategic health authorities and associated charities, and the specialist Trust Practice, which is responsible for the audits of NHS trusts, NHS foundation trusts and associated NHS charities.
- 19 It is also organised geographically into four regions (Central, London, Northern and Southern), which are led and managed by a regional director (RD), who reports to the managing directors for Health and Local Government. One of the RDs acts as the audit practice's nominated audit partner (RD, Audit – Brian Willmor).
- 20 The top management structure is summarised in Figure 1.

**Figure 1**



\*HR - Tracey Dennison

Finance and Corporate Services – Eugene Sullivan

Communications and Public Reporting – David Walker

Policy, Research and Studies – Peter Wilkinson



- 21 The Managing Director, Audit is supported by the Director of Professional Practice, who is responsible for leading and managing the development and implementation of the audit practice's systems and processes for promoting audit quality, comprising:
- the Commission's core audit approach, and related audit tools and documentation;
  - the provision of technical information and support, and training for auditors;
  - the provision of a range of technical services to auditors and audited bodies; and
  - quality monitoring and compliance.
- 22 He also acts as the Audit Practice's ethics partner in accordance with the Auditing Practice Board's Ethical Standard (ES) 1: Integrity, objectivity and independence.
- 23 At the regional level, professional leadership of the audit practice is the responsibility of the Heads of Audit, who have specific responsibility for promoting audit quality and for ensuring compliance with our practice-wide systems and processes. They also have a role in the appointment and performance monitoring of the audit practice's engagement leaders (district auditors, engagement leads and senior audit managers). The Heads of Audit are line managed by their RDs, but have a line of professional accountability to the Managing Director, Audit. Heads of Audit are supported by sub-regional Heads of Audit.
- 24 Together, the Managing Director, Audit; RD, Audit; Director of Professional Practice; the four regional Heads of Audit; the Head of Professional Standards; and a Head of Operations comprise the Audit Practice Development Group, which is responsible for providing professional leadership to the audit practice.
- 25 The Audit Practice Development Group is supported by four standing groups:
- the Audit Practices Committee, which oversees the development of our audit approach, and associated tools and documentation;
  - the Audit Standards Committee, which oversees the development and monitors the effectiveness of the audit practice's systems and processes for promoting audit quality and compliance;
  - the Human Resources Committee, which leads the development of our approach on all HR issues relevant to promoting audit quality, including people development and training; and
  - the Technical Committee, which is responsible for developing the audit practice's line on technical policy and emerging technical issues, and advising on the appropriate response on specific technical issues arising at particular audits.

# The Commission's approach to audit quality

## Background

26 Audit quality has been defined by the Audit Inspection Unit (AIU)<sup>1</sup> as the combination of:

- an appropriate audit opinion which is independent and is supported by sufficient and appropriate evidence, and objective evidenced judgements; and
- audit reports to those charged with governance, which are complete and appropriate to the circumstances.

27 Taking this definition and building on it to reflect the public sector context, the Commission's practice defines audit quality as the consistent and efficient delivery of audits that:

- comply with professional standards and other regulatory requirements; and
- have impact.

28 There are a number of features of a quality audit. Table 4 sets out the key attributes that contribute to the delivery of a quality audit.

**Table 4**

Feature	Attributes
Evidence-based	Sufficient appropriate audit evidence is obtained. Audit processes, findings and conclusions are documented fully and clearly.
Independence	The auditor is, and is seen to be, independent and objective by applying challenge and professional scepticism to the audit. Ethical Standards are complied with.
Legal and technical compliance	Professional auditing standards and other Commission requirements are applied and documented.
Risk-based	Audit effort is properly targeted at the areas of greatest audit risk.
Timely	Audit work is undertaken at the appropriate time. Key reports and other audit outputs are finalised and delivered on a timely basis.

<sup>1</sup> The AIU was set up in 2003 to monitor the quality of audits of public interest entities in the private sector. It forms part of the independent framework for the regulation of the accountancy profession that was set up in the UK in response to the collapse of Enron and the demise of Andersen, which is overseen by the Financial Reporting Council.

Feature	Attributes
Impact	Appropriate impact is achieved through the auditor's engagement and relationship with the audited body, the key judgements reached and reported, and the outcomes delivered or supported by the audit process.
Efficient	Appropriate and efficient audit procedures are applied. Staff with appropriate experience and qualifications are used where required.

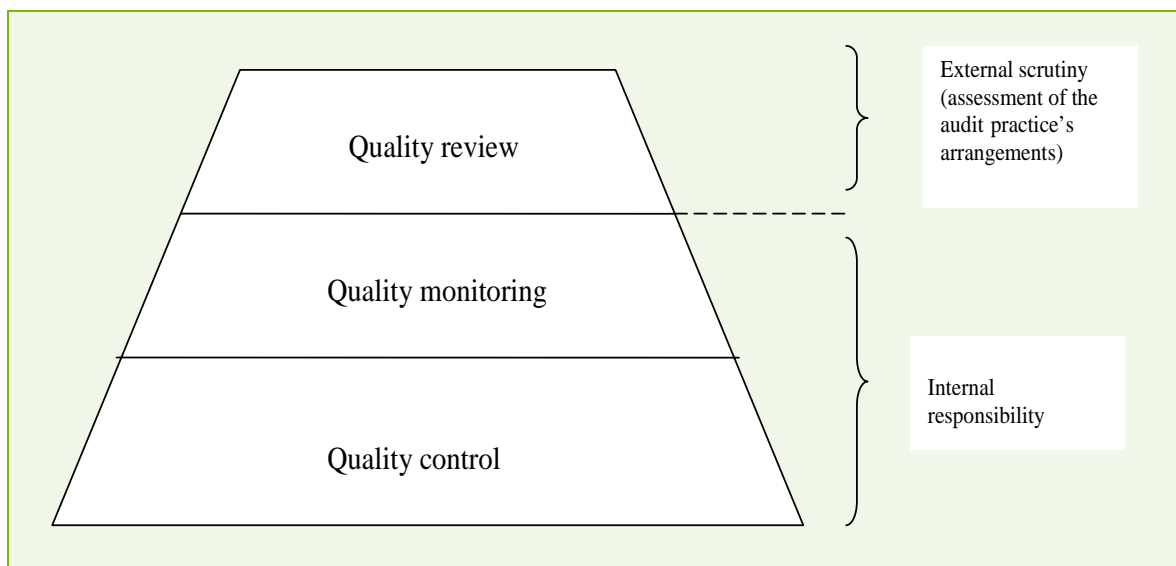
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- 29** A quality audit will be the sum of these parts. Weaknesses in one or more of these features will present a threat to audit quality. For this reason, we apply a structured quality framework to ensure the necessary building blocks are in place to support quality audit work. We monitor the delivery of our work to assess compliance with these requirements.
- 30** In February 2008 the Financial Reporting Council published *The Audit Quality Framework*. This document outlines five key drivers of audit quality:
- the culture within an audit firm;
  - the skills and personal qualities of audit partners and staff;
  - the effectiveness of the audit process;
  - the reliability and usefulness of audit reporting; and
  - factors outside the control of auditors affecting audit quality.
- 31** The Audit Commission has completed a self-assessment against these five key drivers. This is shown in Appendix 1.
- 32** The Commission's audit practice is committed to delivering quality audits and, to that end, has put in place systems and processes through which:
- the achievement of high quality is valued, invested in and rewarded;
  - the underlying skills and personal qualities of staff are developed through the technical training and personal development provided, and the appraisal regime applied;
  - we deploy an appropriate audit team, provide high-quality technical support, utilise an established and documented audit methodology, and comply with the requirements of ethical standards and quality control standards; and
  - our opinions and audit outputs are standardised where appropriate and are consistent with legal and auditing standards, so that our communication with those charged with governance and management throughout the audit contributes towards a high-quality audit outcome.

## The Commission's approach to audit quality

### Our quality framework

- 33** Our quality framework has been developed to meet the standards set out in ISQC (UK&I) 1, which sets out standards and provides guidance regarding a firm's responsibilities for its system of quality control for audits and reviews of historical financial information, and for other assurance and related services engagements.
- 34** However, it goes beyond this standard in order to meet certain additional requirements of the Commission's audit regime. In addition, individual engagement partners are required to comply with the requirements of ISA (UK&I) 220: Quality control for audits of historical financial information.
- 35** The quality framework, together with supporting procedures and policies, is documented in the audit practice's Audit Manual in accordance with ISQC (UK&I) 1. It is subject to review on an annual basis by the Audit Standards Committee.
- 36** The framework comprises three elements.

**Figure 2**



- 37** This three-level approach highlights that the foundation of our quality framework is built on quality control. This means embedding quality controls into our processes to ensure that we get things right first time.

### Changes in the quality framework in the last 12 months

- 38** We are committed to reviewing, developing and enhancing our quality framework, including in response to the findings of the first inspection undertaken by the AIU, which were summarised in last year's quality report.

**39** Over the last 12 months the audit practice has strengthened its quality control arrangements by:

- making changes to improve and enhance the audit approach (including issuing updated versions of the electronic audit manual to all staff);
- codifying its ethical policies and procedures in a comprehensive ethics manual, which is made available in electronic format to all staff;
- revising and expanding the graduate programme;
- revising arrangements for contractors, including the provision of staff by a 'big four' firm;
- enhancing guidance and support for performance management of staff;
- producing advanced resource planning guidance and toolkits for the regional teams;
- enhancing the technical resources available to our auditors, in particular by providing access to expert actuarial and valuation services;
- enhancing the audit training programme, drawing on private sector skills; and
- refining its arrangements for engagement quality control reviews.

**40** It has also strengthened its quality monitoring. In particular:

- it has doubled the scope of the annual programme by introducing a review of a second engagement for the great majority of engagement leads selected for review; and
- it has increased the focus on compliance with auditing standards as part of the review programme, ensuring that the requirements of key standards are explicitly covered every year and those of all standards are covered over a three-year period.

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### Quality control

**41** As the audit practice's quality partner, the Managing Director, Audit is responsible for ensuring that our embedded quality control processes are fit for purpose.

**42** Our quality control processes have been developed to meet the requirements of ISQC (UK&I)<sup>1</sup> and are designed to ensure:

- appropriate professional leadership throughout the practice, which promotes a quality audit culture;
- compliance with ethical standards, regarding:
  - the integrity, objectivity and independence of our staff;
  - professional competence (qualifications and training);
  - confidentiality;
  - rules regarding professional behaviour; and

## The Commission's approach to audit quality

- the availability of sufficient staff with the capabilities and competence to perform our audits:
  - applying an agreed audit approach and reporting framework;
  - specifying requirements for supervision and review;
  - determining the circumstances under which consultation and independent review are required; and
- the provision of appropriate technical support and advice to auditors on difficult or contentious audit matters.

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### Quality monitoring

- 43 The next tier in our quality framework is our monitoring arrangements, which are designed to provide assurance that our systems of quality control are relevant, adequate, operating effectively and delivering the intended outcomes. The quality monitoring function is overseen by the audit practice's Audit Standards Committee.
- 44 In accordance with ISQC (UK&I)1 it develops and monitors the implementation of an annual quality monitoring programme designed to evaluate the quality control processes, and to obtain reasonable assurance that our systems of quality control are operating effectively.
- 45 The programme comprises eight main elements.
- Quality monitoring reviews (QMRs) of completed audit engagements which are designed to:
    - monitor compliance with the audit approach, including compliance with professional standards and other requirements;
    - review key judgements and ensure that they are supported by sufficient, appropriate and evidenced work; and
    - assess whether quality control systems and other systems and processes put in place to promote audit quality are designed appropriately and are being applied effectively.

QMRs are required for:

- all engagement leads over a three-year cycle, in other words approximately one-third per annum are subject to review;
- all new engagement leads in the first year of appointment; and
- any engagement lead who has not met minimum standards in a prior year quality review (this includes internal QMRs and external quality reviews).

As part of the expanded programme, we introduced a desk-based review of a second engagement for all engagement leads subject to QMR with a portfolio of more than five engagements. These reviews are used to assess compliance with professional standards rather than the full breadth of review undertaken as part of a QMR.

- Review of the local application of quality control procedures. Engagement teams are required to complete a quality control checklist at two key stages of the audit (initial planning and prior to giving the opinion). The completion of this checklist (plus additional audit procedures) is then independently peer reviewed by a designated local audit quality lead.
  - Quality monitoring of performance audit work, which is completed to ensure compliance with quality control procedures. Reviews are undertaken on a random sample of completed performance projects each quarter.
  - Client satisfaction surveys, which are used to obtain the views of audited bodies on the quality of the service provided by auditors, their relationship with the audit team and the impact of auditors' work.
  - Quality monitoring of the Audit Commission Technical Support service (ACTS), the technical information service to auditors, to check adherence to professional standards, and overall adequacy (including timeliness), of technical responses provided to auditors. Quarterly reviews are undertaken on a random sample of all queries answered.
  - Review of audits undertaken under the Audit Commission's limited assurance regime (those local government entities with income or expenditure of less than £1 million). These are completed to assess compliance with the procedures specified by the Audit Commission. Engagements are randomly selected from the total population of limited assurance reviews.
  - Review of regional office processes, to ensure our various compliance processes are properly designed and are operating effectively. Reviews are undertaken in each of the four regions.
  - Review of the certification of claims and returns, to ensure compliance with the Audit Commission's Certification Instructions. A sample is selected from the total population of all certified claims and returns having regard to their size and relative complexity.
- 46 The findings of our quality monitoring programme are logged and reported to the Audit Standards Committee, which identifies the key learning points and monitors the implementation of the corrective actions that are needed to address any weaknesses identified. The overall messages and the actions taken in response to them are reported to, and considered by, top management and then disseminated within the practice.
- 47 The results of our 2007/08 quality monitoring programme are summarised in the next section.



### Quality review

**48** The final tier in the framework is quality review. This is provided by independent review of practice-wide systems and individual engagements by:

- The AIU. The Audit Commission has invited the AIU, the independent body which is responsible for providing assurance about the quality of the audits of public interest entities, to inspect its audit practice, to provide independent assurance about the quality of its audits.
- The Quality Assurance Directorate (QAD) of the ICAEW. The QAD reviews our foundation trust audits on behalf of Monitor (the Independent Regulator of Foundation Trusts).

The results of quality reviews are reported to the Commission Board. The findings of reviews of our 2007/08 audits are summarised in the next section.

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### Independence procedures and practices

**49** The Audit Commission believes that the independence of auditors – and public perception of the independence of auditors – is central to the credibility of the audit profession. Notwithstanding the presence of the important safeguard of independent appointment of auditors to local authorities and NHS bodies, the Commission goes beyond the requirements of Ethical Standards in respect of bodies within its audit regime, applying provisions applicable to listed entities to all but the smallest of the entities within its regime.

**50** A strict framework of independence rules is applied to Audit Commission engagements. For principal audit engagements this requires the engagement lead, and engagement quality control reviewer (if appointed) to rotate after five years, and audit managers to rotate after seven years. For audits under the limited assurance regime and charity appointments, the time periods are seven and ten years respectively for these roles. Compliance with the rules on independence is overseen by the Director of Professional Practice and the four regional Heads of Audit. Corporate monitoring is overseen by the Professional Standards Division of the Audit Commission via the annual regional office review process.

**51** On an annual basis all Audit Practice staff, including those within the central technical support function, are requested to complete an annual independence declaration. In line with the Ethical Standards, this declaration includes consideration of all potential threats to independence. All declarations received are reviewed and cleared by the relevant regional Head of Audit (for regional audit staff), or by the Head of Professional Standards (for central staff).

**52** In relation to advice and assistance work, the Audit Commission places stringent rules on the use of powers granted under the Local Government and Public Involvement in Health Act 2007. These rules are over and above those required by the Auditing Practices Board Ethical Standard 5.



- 53 All advice and assistance work requires approval by the individual engagement lead and the relevant regional Head of Audit. In respect of audit appointments falling within the Audit Commission regime, where the value of proposed advice and assistance work exceeds the higher of £30,000 or 20 per cent of the annual audit and inspection fee (which is applied cumulatively to each audit year), approval is required from the Commission's Director of Audit Policy and Regulation. All such work is recorded and approved on a centralised electronic database.
- 54 We have monitored compliance with our rules on rotation, independence declarations and non-audit services during 2009.
- 55 The audit practice also maintains a range of other systems and processes designed to safeguard auditors' independence:
- a comprehensive ethics manual and technical support service for ethical issues;
  - an approved list of services which are not permitted to be provided to audit and inspection bodies;
  - the completion and monitoring of gifts and hospitality registers;
  - declaration of the 'Fit and Proper' status of all staff members providing audit services; and
  - declaration of financial and business interests held by senior staff (earning greater than £50,000 per annum) via an annual circularisation for related party transactions.
- 56 All of these processes have been operating during 2009.

# Results of our 2007/08 quality monitoring programme

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## Summary

- 57** The key messages from the programme carried out in 2008/09 (on 2007/08 engagements) are as follows.
- The quality of the audit practice's work continues to meet professional standards. Areas for improvement have been identified and acted upon.
  - Local quality leads' quality reviews provide ongoing assurance that auditors are complying with organisational requirements. Areas for improvement have been identified and acted upon.
  - Improvements are evident in the adherence to quality standards for local performance work although there remains scope for improvement in some key areas.
  - Audited bodies' satisfaction with their auditors remains high.
  - The technical advice provided to auditors is robust, timely and complies with internal standards.
  - Our reviews of audits undertaken under the limited assurance regime found that the processes in place are well-established and operating effectively.
  - Levels of compliance with local quality systems and processes were high and there were no issues of significant concern.
  - Claims and returns continue to be certified to a good standard.
- 58** We are taking action in response to each of these key messages, which are being fed back to staff through regional Heads of Audit and their local quality leads. They are being reinforced through events for the professional leadership of the audit practice and through our national technical training programme. At local level, improvement opportunities are being reflected in local quality plans.

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## Quality monitoring reviews

- 59** The 2008/09 quality monitoring review programme (which reviewed completed audits for 2007/08) comprised reviews of 57 audits (23 in the prior year) which were undertaken between December 2008 and February 2009. All 57 were reviewed by teams of the audit practice's own staff.

- 60 Reviewers identified two instances (4 per cent) of significant non-compliance with specific auditing standards. This compares with two instances (9 per cent) in the prior year. The remaining engagements were assessed as meeting the required standards (or better) and three audit engagements were assessed as meeting the highest standard of notable practice (none in the prior year).
- 61 The main lessons learned and areas for improvement that were captured as part of this process included the need to improve:
- evidencing the fraud risk assessment, to meet the requirements of ISA (UK&I) 240: The auditor's responsibility to consider fraud in an audit of financial statements;
  - documentation of the audit approach, to meet the requirements of ISA (UK&I) 330: The auditor's procedures in response to assessed risks; and
  - the application of predictive analytical review, to meet the requirements of ISA (UK&I) 520: Analytical procedures.
- 62 Action has been taken to address the matters raised by these reviews, including formal briefings to all engagement leads within the audit practice, tailoring of the auditor training programme and revisions to our audit support tools.
- 63 Where weaknesses were identified at individual audits, the engagement leads have prepared a formal response and action plan for the regional Head of Audit, setting out how they propose to respond.

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### Local quality leads

- 64 The audit practice maintains a network of local quality leads. These are experienced audit managers nominated by engagement leads and endorsed by the Regional Head of Audit.
- 65 Local quality leads undertake a review of at least one file for every audit manager each year. The reviews are based on quality monitoring the completion of quality control checklists on individual audit engagements. The quality control checklists are approved by the Audit Practices Committee, although the quality monitoring process is overseen by the Audit Standards Committee. The breadth of coverage is greater than any other quality monitoring activity with over 200 reviews undertaken.
- 66 Results from these reviews are reported to the engagement leads, summarised for each regional Head of Audit and reported to the Audit Standards Committee. In 2009, these reviews confirmed high levels of compliance by engagement leads and audit managers throughout the audit practice.
- 67 Areas for improvement identified through these reviews (relating to individual engagements) are addressed through local action plans and monitoring by the regional Head of Audit. Organisational weaknesses highlighted by these reviews are identified by the Professional Standards Division and reported to Audit Standards Committee. Corrective action is identified where appropriate.

### Quality monitoring of performance audit work

- 68 The quality of our performance audit work and of the reports we produce has a major influence on the impact we have in driving up performance in the public sector. They provide an opportunity for auditors to contribute to improvements in local services, in value for money and, ultimately, in outcomes for local people. This year's quality monitoring comprised a review of 54 files (55 in the prior year) from across the audit practice.
- 69 The reviews, which are completed on a quarterly basis, were undertaken by senior performance audit staff from across the audit practice.
- 70 The results demonstrate steady and sustained improvement in quality over the year. Most notably, this includes evidence of good compliance with quality control processes. The overall quality of final reports has improved. However, there remains scope to improve the documentation of the agreement of project specifications with the audited body and retaining evidence of this on the audit file.

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### Client satisfaction surveys

- 71 The views of our clients are an important element in assessing the quality of the work delivered. In 2008/09 we conducted an electronic survey of audited bodies in the health sector, with a view to rolling the survey out to the local government sector.
- 72 The client satisfaction survey was undertaken between November 2008 and February 2009 and 115 bodies were surveyed. The survey included questions on the delivery of the audit, quality of interaction with audit practice staff and an overall assessment of satisfaction.
- 73 The response rate was 40 per cent. The majority of respondents appear very satisfied with the audit work carried out, with 68.2 per cent rating their satisfaction as 8 or above on a scale of 1 to 10, where 10 is completely satisfied. The average rating was 8.1 out of 10.
- 74 The equivalent process will be followed for surveying local government audited bodies in early 2010.

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### Quality monitoring of ACTS

- 75 The provision of high-quality, timely and accurate, technical advice is one of the foundations of high-quality audit work. ACTS is a dedicated information service staffed by experienced members of the audit practice. It answers approximately 3,000 queries per annum.
- 76 The quality monitoring of ACTS involves the independent review of a sample of technical responses each quarter. The responses are assessed for compliance with professional standards, adherence to quality control processes, timeliness and overall readability.

**77** The reviews have confirmed that ACTS continues to provide a high-quality and timely service to auditors. All responses have been designated as meeting standards (or better). There have been no instances where the overall score for an ACTS response has been scored as inadequate, in other words standards not met. However, there remains scope for improvement in ensuring that:

- all responses are given within the agreed timescale deadline; and
- all high-risk queries are peer reviewed.

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### Review of audits undertaken in the limited assurance regime

**78** The audit practice is responsible for the audit of 2,500 bodies under the limited assurance regime. These bodies have gross income or expenditure of less than £1 million and the auditor undertakes a limited range of procedures and reports on a negative assurance basis.

**79** As part of this year's quality monitoring we reviewed the overall processes in place for delivering the audits, plus a sample of 36 engagements (44 in the prior year).

**80** The review found that, overall, processes were operating well, although it is appropriate to refresh the audit manual and quality control procedures that apply to this regime. All 36 audit opinions were supported by sufficient appropriate audit work.

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### Review of regional office processes

**81** A number of the audit practice's procedures for compliance with Ethical Standards, the Audit Commission's Code of Audit Practice and the Audit Commission's regulatory requirements set out in its *Standing Guidance for Auditors* are operated at regional level. We therefore review procedures at regional level to provide assurance that appropriate procedures are in place and operating.

**82** Levels of compliance with local procedures were high throughout each of the regions and there were no issues of significant concern.

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### Review of certification of claims and returns

**83** Auditors, at the request of audited bodies (and in the role of agents to the Audit Commission), certify various claims and returns for grant-paying bodies. The certification is conducted in accordance with a set of instructions specified by the Commission.

**84** As part of the annual quality monitoring programme, a sample of 40 claims and returns was selected for review. The scope of the review focused on compliance with the relevant Audit Commission Certification Instruction.

## Results of our 2007/08 quality monitoring programme

- 85 Overall, the claims and returns were certified to a good standard. Of the 40 claims and returns reviewed, one instance of significant non-compliance was noted and appropriate remedial action (removal of the individual's signing authority) was taken immediately.
- 86 The reviews highlighted the need for marginal improvement in:
- compliance with requirements of the Certification Instruction; and
  - documentation of the results of certification work.
- 87 Individual engagement learning points have been discussed with those auditors subject to review and shared with the wider audit practice. Where necessary, changes have been made to procedures. We have also fed back the findings to the Audit Commission's grants team so that it can consider whether any changes in certification instructions might be appropriate.

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# Results of external quality reviews

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## The AIU's inspection of the audit practice

### Background

- 88 In last year's annual quality report we summarised the findings and results of the first annual inspection of the audit practice by the independent AIU.
- 89 The AIU was set up in 2003 to monitor the quality of audits of public interest entities in the private sector. It forms part of the independent framework for the regulation of the accountancy profession, which was set up in the UK in response to the collapse of Enron and the demise of Andersen, and which is overseen by the Financial Reporting Council.
- 90 Our decision to invite the AIU to inspect our audit practice was a key element in our Promoting audit quality change programme, to strengthen our firm-wide systems and processes for ensuring audit quality and drive up the quality of our audit work. This reflected our belief that the process of rigorous external scrutiny and challenge would be extremely positive and helpful to us in benchmarking our performance and in identifying what we need to do to improve, and how.
- 91 The AIU's report was comprehensive and identified areas where improvements were, in its view, needed in order to enhance audit quality and/or comply with professional and regulatory requirements. The majority of its findings related to firm-wide procedures, which was consistent with the AIU's experience when it first visited other firms.
- 92 We accepted all of the AIU's findings. We developed a comprehensive action plan and a timetable for implementation of the recommended changes. Work on the action plan was led by our Audit Practice Development Group, working closely with the Managing Director, HR and the regional directors. The action plan was endorsed by the Commission Board, which monitored progress on its implementation.
- 93 We have been able to implement nearly all of the recommended changes that were of a technical and professional nature. However, as the AIU acknowledged, in a number of areas, changes will be more difficult to make and can only be implemented over an extended period. The main changes we have made in response to the AIU's inspection and the further changes that are still in progress are summarised in the section 'Changes in the quality framework in the last 12 months' (summarised in Paragraph 39).

## Results of our 2007/08 quality monitoring programme

### The AIU's approach

- 94 The AIU's inspection team was on site in the period from February to May.
- 95 In this year's inspection, the AIU followed up our actions in response to last year's findings, but focused most of the inspection on reviewing a further sample of seven individual audits (file reviews), covering a range of entities audited by the audit practice.

### The AIU's findings

- 96 Once again, the AIU has acknowledged our commitment to improving audit quality. In particular, it is complimentary about the progress made in relation to its findings last year:

**'The Commission's commitment to improving audit quality is clearly evident from its willingness to submit to an inspection process of this nature on a voluntary basis. The manner in which it has responded to the considerable challenges arising from the number and nature of findings identified in the prior year inspection is, in our view, commendable.'**

- 97 The AIU singled out the following areas where we have made significant progress.
- Revision and expansion of the graduate programme.
  - Revisions to arrangements for contractors including the provision of staff by a 'big four' firm.
  - Improvements to the Performance Management System as evidenced by the broader distribution of performance grading for 2009.
  - Development and implementation of a comprehensive ethics manual.
  - Revision and expansion of the Quality Monitoring Review programme.
  - Arrangements for the provision of specialist actuarial and property valuation advice to auditors.
- 98 The file reviews have reaffirmed the messages of last year's report. This is to be expected, as the engagements reviewed related to the 2007/08 financial year and so had been planned and carried out on the same basis as the audits for 2006/07 reviewed by the AIU last year. They had been completed or were nearing completion by the time that the AIU presented its first report last year.
- 99 While the AIU raised a large number of points on the audits reviewed, its overall conclusion was that:
- 'None of the issues identified from our reviews were considered to be individually significant, nor did we identify any instances where we believe an inappropriate audit opinion was issued'.**



**100** However, it commented that it had found a wider variation between the audits reviewed this year. It concluded:

**‘Overall, we considered that one audit stood out as good, three required some improvement and three required a greater degree of improvement as indicated by the number of issues identified.’**

**101** The file reviews also identified general themes for improvement. The AIU highlighted issues relating to the leadership of engagements by district auditors and audit managers – in planning, guiding, concluding and reporting on the audits.

**102** The AIU also commented further on our audit approach. The most significant point it raises relates to the nature and extent of substantive testing of income and expenditure where reliance is placed on controls testing. We recognise that when the new ‘clarified’ international auditing standards apply from 2010/11 audits we will need to extend the scope of substantive testing. This will have potentially significant implications for the way in which we plan and perform audits.

### How we are responding

**103** We accept the findings from the file reviews. In particular, we have identified the leadership role of engagement leaders and audit managers as a key part of our plans to develop the audit practice, and we are acting on it with specific training for engagement leaders.

**104** Our broad challenge is to ensure the more consistent application of the audit approach by all audit teams and to secure the improvements in audit quality that the changes in our firm-wide systems and processes are designed to support.

**105** In this respect, next year’s inspection will be critical as many of the technical changes we have made should be visible in the individual 2008/09 audits that the AIU will be reviewing then and reflected in its assessments of audit quality. However, other changes we are making will take longer to make a significant impact.

**106** Similarly, we accept almost all of the findings about our audit approach and will make the necessary amendments to the Audit Manual.

**107** As last year, we will develop a comprehensive action plan on all of the issues raised by the AIU this year, against which we will monitor our progress during the year.

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### Quality Assurance Directorate’s (QAD’s) review of the quality of the audit practice’s foundation trust audits

**108** The Audit Code for NHS foundation trusts makes provision for the review of the work of auditors of NHS foundation trusts. Monitor commissioned the QAD of the ICAEW to undertake reviews of audits of NHS foundation trusts for 2007/08. As part of this programme, QAD reviewed four audits carried out by the audit practice’s Trust Practice (ten in total across all audit suppliers to the foundation trust regime).

**109** The aim of the reviews is to provide assurance to Monitor that the auditors reviewed complied with the Audit Code and that audits were of a high standard and suitable quality.

## Results of our 2007/08 quality monitoring programme

**110** Monitor has summarised the key findings of QAD's reviews of all auditors of NHS foundation trusts as follows.

- QAD found no indication that an incorrect audit opinion had been given.
- Audits were of a sufficiently high standard and suitable quality, with appropriate audit evidence having been obtained.
- The number and significance of matters identified by QAD has continued to diminish, continuing the trend from previous years.
- Auditors had complied with the requirements of the Code in all material respects other than in two instances where the significance of the finding was regarded as amounting to an isolated instance of non-compliance with a particular section of the Code.

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### The Audit Commission's Annual Quality Review Programme

**111** The Audit Commission reviews the quality of work of all suppliers in its audit regime. In doing so, it places reliance on the work of the AIU. It also carries out its own programme of reviews of auditors' value for money and grant certification work, and compliance with its regulatory requirements. The results of its reviews of 2007/08 audits are summarised in its *Quality Review Programme: Annual Report 2009*, which is published on the Commission's website at [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

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# Our commitment to audit quality

**112** The Commission's audit practice has set itself the aim of being a world leader in public sector audit and delivering world class audits consistently and efficiently.

**113** To deliver this aim, we are continuing to roll out a major change programme, Promoting audit quality, to:

- enhance professional leadership at all levels within our audit practice;
- strengthen our core professional infrastructure, so that it is commensurate with the size and status of our audit practice; and
- respond to the findings of the AIU's inspection of our practice.

**114** In the last 12 months we have built on progress to date, building our professional capacity and engaging the whole of the professional leadership of the audit practice in the change programme.

**115** More specifically we have:

- committed almost £3 million to an expanded graduate training programme, including a bespoke professional accountancy qualification. This will be delivered over the next three years starting from the autumn of 2009;
- let new contracts for the external provision of high-quality qualified contract audit staff to support appointed auditors and their teams;
- produced advanced resource planning guidance and toolkits for the regional teams;
- expanded the breadth and depth of the internal quality monitoring programme;
- let new contracts to update the technical resources available to our auditors. This has included access to expert actuarial and valuation services; and
- produced and communicated to all staff a new ethics manual.

# Appendix 1 – Financial Reporting Council's audit quality framework

Audit quality driver	Audit Commission arrangements
The culture within an audit firm	<p>Staff are reminded of the importance of integrity, objectivity and independence in their role as auditors. Our requirements are set out in a comprehensive ethics manual, which is available electronically to all members of the Audit Practice, and through the annual independence declaration process.</p> <p>Audit teams have sufficient time and resources to consult on technical matters and engagement leads are encouraged to exercise professional judgement.</p> <p>Financial considerations do not drive actions and decisions – staff are not remunerated for and their performance assessment is not influenced by selling non-audit services to audit engagements. Engagement leads are salaried permanent employees.</p> <p>Performance appraisals and assessments include a strong focus on delivering audit quality.</p> <p>Quality control and quality monitoring processes are well established. The results of the quality monitoring programme are transparent within the Audit Practice.</p>

Audit quality driver	Audit Commission arrangements
The skills and personal qualities of audit partners and staff	<p>Only experienced engagement leads and team members are deployed on audit engagements. Having a full knowledge and understanding of the entity and its wider sector is a prerequisite of this.</p> <p>Coaching and briefing is an integral part of all engagements.</p> <p>Compliance with auditing and ethical standards is actively promoted and adherence is routinely monitored through established quality control, monitoring and review processes.</p> <p>Audit team members are reminded of the need to exercise professional scepticism and remain objective in the exercise of judgement. Reminders are included in technical guidance material issued to auditors and also throughout the audit training programme.</p> <p>All staff deployed on audit engagements are sufficiently experienced and are appropriately supervised by more-senior team members.</p> <p>Audit team members are required to participate in audit training. This includes mandatory and optional elements, and specific focus is given to continuing professional development and improving sector knowledge.</p>

## Appendix 1 – Financial Reporting Council's audit quality framework

Audit quality driver	Audit Commission arrangements
The effectiveness of the audit process	<p>The Audit Commission has an established audit methodology which is based on compliance with Auditing and Ethical Standards, plus other legal and regulatory requirements.</p> <p>Staff receive continuous training on the audit approach and the Audit Commission's Audit Manual is available electronically to each audit team member.</p> <p>High-quality technical support is available to all audit team members via the Audit Commission Technical Support service (ACTS), the complex casework support service (CLEAR) and the Audit Commission Ethical Service.</p> <p>The Audit Practice has corporate subscriptions to a variety of legal, regulatory and professional information databases. These are made available to all audit staff.</p> <p>Compliance with Ethical Standards is routinely monitored and acted upon. This includes an independence declaration process, fit and proper declaration, rotation systems and processes, plus gifts and hospitality registers.</p> <p>Audit teams are not inappropriately constrained by financial pressures. Budgets for audit engagements are subject to local and regional review to ensure they are realistic and achievable.</p>
The reliability and usefulness of audit reporting	<p>Communication with those charged with governance (Audit Committee or equivalent) is based on compliance with auditing standards, together with other qualitative factors such as impact and effectiveness.</p> <p>Quality review processes exist to check a sample of audit products (audit plans, audit letters and so on) to ensure reporting is reliable and useful.</p>
Factors outside the control of auditors	<p>Audit teams discuss the importance of audit quality with audited bodies and this is emphasised in our communications.</p> <p>Audit teams work closely with Audit Committee members to ensure effective working.</p> <p>Senior management of the Audit Commission liaise with central government officials on financial reporting developments and also with audit, accounting and other regulatory bodies relevant to our work.</p>

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