



Oldham
Council

Report to Audit Committee

The Financial Reporting Council (FRC) 2022 reports

Portfolio Holder: Councillor Abdul Jabbar MBE, Deputy Leader and Cabinet Member Finance and Low Carbon

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29 November 2022

Reason for Decision

This report presents the latest position paper on the Financial Reporting Council's (FRC) transition to the Audit, Reporting and Governance Authority (ARGA) setting out how trust will be restored in local public external audit, and the FRC's report concerning the quality of Local Authority and National Health Service (NHS) audits across the UK Public Sector, both issued during 2022.

Executive Summary

During 2022 the FRC has issued two documents relevant to external audit in the UK public sector, including Local Authorities, as follows:

- FRC Position Paper – “Restoring Trust in Audit and Corporate Governance”, published in July 2022.
- FRC Major Local Audits – “Audit Inspection Report” published in October 2022.

The FRC Position Paper sets out how the Financial Reporting Council (FRC) will support the Government's reforms as the FRC transitions into ARGA. The legislation to enact the creation of ARGA is still awaited but, in preparation, the FRC in September 2022 recruited a Director of Local Audit.

This FRC Audit Inspection Report sets out the principal findings arising from a review of both the 2020/21 and 2021/22 accounts and Value for Money opinions at all six audit firms completing major local audits in England for both Local Authorities and the NHS (the firms), and how the firms should respond to the FRC findings. It also incorporates the findings of the Quality Assurance Division of the Chartered Institute of Chartered

Accountants for England and Wales who reviewed a selection of the firms undertaking public audit.

The positive finding from this independent review is that for both Mazars LLP (who audit the Council's Statement of Final Accounts) and KPMG LLP (who provide direct grant audit for both Housing Benefit Subsidy and Teachers Pension Agency contributions) the audit quality was found to be good on the audits reviewed.

What is difficult to interpret is whether, because of previously reported inspections by FRC, the overall standard of the audits has improved. The reported quality of the audits from the sample identified for review has improved from the previous report. However, the report alludes to the original sample changing due to the challenges at some organisations in having both the Accounts ready for audit and then completing the audits. As such the audits reviewed have been for those organisations who perhaps have less challenging governance issues.

Recommendations

That Members of the Audit Committee note the contents of the latest FRC position paper and report.

The Financial Reporting Council (FRC) 2022 reports**1. Background and Summary of FRC Position Paper “Restoring Trust in Audit and Corporate Governance”**

- 1.1 The Financial Reporting Council (FRC) is the independent body responsible for monitoring the quality of major local public audits. This monitoring is performed by the FRC’s Audit Quality Review (AQR) team. Their inspection of major local audits aims to hold external audit firms to account for making the changes needed to safeguard and improve audit quality.
 - 1.2 Auditors play a vital role in upholding trust and maintaining public confidence in Local Authorities by auditing financial statements, satisfying themselves that proper arrangements are in place to secure Value for Money (VfM) and, where necessary, exercising additional powers and duties.
 - 1.3 The FRC’s objective is to achieve consistently high audit quality across the UK so that the public can have confidence in the work of local auditors. To support this objective, they have powers to:
 - Inspect the quality of major local public audits.
 - Set eligibility criteria for local auditors and oversee delegated regulatory tasks carried out by professional bodies, such as qualification, training, registration and monitoring of non-major local audits.
 - Consider the implications of poor audit quality and bring enforcement action against auditors, if appropriate, in cases of a breach of the relevant requirements.
 - 1.4 In May 2022, the Department for Levelling Up, Housing & Communities (DLUHC) published the Government’s response to ‘Local Audit Framework: technical consultation’. This set out the next steps to implement the recommendations of the Redmond Review, including improving the oversight of local audit and the transparency of local authority financial reporting.
 - 1.5 The Government has indicated that the Audit, Reporting and Governance Authority (ARGA) will be the systems leader for local authority financial reporting and audit. Legislation is required to ensure that ARGA has the powers it needs to hold to account those responsible for delivering the required improvements.
 - 1.6 In July 2022, the FRC published its position paper setting out the next steps in its transition to ARGA. A Director of Local Audit, who started in September 2022, has been recruited to make preparations to take on the role of systems leader in shadow form. FRC priorities are currently:
 - Carrying out stakeholder outreach to determine priorities and early action areas for ARGA.
 - Working with the Department for Levelling Up, Housing and Communities (DLUHC) and the National Audit Office to facilitate the transfer of the Code of Audit Practice, when legislation allows.
 - Working with the DLUHC, HM Treasury and CIPFA Local Authority (Scotland) Accounts Advisory Committee (LASAAC) to determine whether the current complex financial reporting framework for Local Authorities can be simplified, whilst still meeting HM Treasury’s reporting requirements in support of the Whole of Government Accounts.
 - Building on the success of Practice Note 10 for the Central Government Sector by consulting on proposals for a specific practice note for local public audit in England.
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2. Summary of FRC “Audit Inspection Report” findings published in October 2022

2.1 The latest FRC Audit Inspection Report sets out the principal findings arising from both the 2020/21 and 2021/22 Statement of Final Accounts reviewed in the 2021/22 cycle of inspections at all six audit firms completing major local public audits in England (the firms), and how the firms should respond to the FRC findings.

2.2 The FRC reports that timeliness of local auditor reporting is poor. Timeliness is a key matter and it promotes transparency and accountability. Audited bodies, local auditors and those with regulatory responsibilities must continue to work together to restore timely completion of audits so that public confidence is not further diminished. The report identifies three issues preventing timely reporting namely:

- A lack of resources at the firms to undertake the audit.
- The increased complexity of the financial statements.
- Unresolved accounting Issues (Infrastructure Assets is one such issue).

Interestingly one firm, BDO Stoy Hayward, cites that one reason why it did not bid for future local public audit work was lack of staffing resources.

2.3 Table 1 below summarises the findings of the FRC reviews by firm with regard to the work carried out in connection with their audit of both their clients’ financial statements, and their work on Value for Money opinions. What is difficult to interpret is whether because of previously reported inspections by FRC, the overall standard of the audits has improved. The reported quality of the audits from the sample identified for review has improved from the previous report. However, the report alludes to the original sample changing due to the challenges at some organisations in having both the Accounts ready for audit and then completing the audits. As such, the audits reviewed have been for those organisations who perhaps have less challenging governance issues. The positive finding from this independent review is that for both Mazars LLP (who audit the Council’s Statement of Final Accounts) and KPMG LLP (who provide direct grant audit on both the Housing Benefit Subsidy and Teachers Pension Agency contributions) the audit quality was found to be good on the audits reviewed.

2.4 The firms are listed in order of that with the highest number of major local audit engagements, Grant Thornton UK LLP, down to the firm with the least, Deloitte LLP. The percentage figures in bold represent the percentage of those engagements reviewed by the FRC where the firm’s work was assessed as either “good or limited improvements required”. The higher this percentage figure therefore, the better. The explanatory text underneath each percentage expands on this outcome to show the size of the sample and further details of the results.

2.5 The more major local audits undertaken by the firm, the larger and, arguably, more representative the sample is likely to be of the firm’s work as a whole. However, as can be seen in Table 1 below, there are some notable differences in results with only Mazars LLP and KPMG LLP achieving a “clean sheet”, and BDO LLP appearing to perform somewhat less favourably overall.

Table 1: FRC inspection results by category and firm

Firm	Audit Inspection Results	VfM Inspection Results
Grant Thornton UK LLP	71% (Five of the seven audits inspected were assessed as either good or limited improvements required)	100% (All four VfM arrangements inspections were assessed as good or limited improvements required)
Ernst & Young LLP	50% (Two of the four audits inspected were assessed as requiring more than limited improvements)	100% (All three VfM arrangements inspections were assessed as good or limited improvements required)
Mazars LLP	100% (All three financial statement audits inspected were assessed as good or limited improvements required)	100% (All three VfM arrangements inspections were assessed as good or limited improvements required)
KPMG LLP	100% (The two financial statement audits inspected were assessed as good or limited improvements required)	100% (The two VfM arrangements inspections were assessed as good or limited improvements required)
BDO LLP	50% (One of the two financial statement audits inspected was assessed as requiring significant improvements)	0% (The one VfM arrangements inspection was assessed as requiring significant improvements)
Deloitte LLP	50% (One of the two financial statements audits inspected was assessed as requiring significant improvements)	100% (The one VfM arrangements inspection was assessed as good or limited improvements required)

2.6 The report also includes details of the Quality Assurance Division (QAD) of the Institute of Chartered Accountants for England and Wales (ICAEW). 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. As a result, not all firms are reviewed every year. In 2021/22 ICAEW undertook reviews of Grant Thornton UK LLP (eight files), Ernst & Young LLP (eight files) and PricewaterhouseCoopers LLP (one file). PricewaterhouseCoopers LLP has no major local audits and so isn't included elsewhere in this report, but the audit reviewed by ICAEW was graded 'good'.

2.7 Overall, the audit work of Grant Thornton UK LLP which ICAEW reviewed was of a good standard. Seven of the eight files reviewed were either good or generally acceptable, but one file required improvement. ICAEW concluded that one file needed improvement due to the insufficient challenge of management's expert on long-term asset valuations. This file was a 2019/20 audit and therefore, does not reflect recent improvements the firm has made in this area, following feedback from external reviews in 2020. VfM work was good on each of the files reviewed, and ICAEW did not identify any issues with this aspect of the firm's work.

2.8 Overall, the audit work of Ernst & Young LLP which ICAEW reviewed was of a good standard. Of the eight files reviewed, seven were either good or generally acceptable, but one file required significant improvement. In the file needing significant improvement, the audit team needed to improve the work done to assess the classification of certain assets as investment properties and whether the negative investment property valuations were appropriate and complied with accounting standards. Improvement was also required on the same file in relation to the audit team's consideration of the cashflow statement, with the ICAEW review identifying two material errors.

3 **Options**

3.1 The Audit Committee can either:

- a) choose to note the contents of the latest FRC position paper and report.
- b) decline to note the contents of the latest FRC position paper and report.

4 **Preferred Option**

4.1 The preferred option is option (a), that the Audit Committee notes the contents of the latest FRC position paper and report.

5 **Consultation**

5.1 N/A.

6 **Financial Implications**

6.1 N/A.

7 **Legal Services Comments**

7.1 N/A.

8 **Co-operative Agenda**

8.1 N/A.

9 **Human Resources Comments**

9.1 N/A.

10 **Risk Assessments**

10.1 N/A.

11 **IT Implications**

11.1 N/A.

12 **Property Implications**

12.1 N/A.

13 **Procurement Implications**

13.1 N/A.

14 **Environmental and Health & Safety Implications**

14.1 N/A.

15 **Equity, Community Cohesion and Crime Implication**

15.1 N/A.

16 **Equality Impact Assessment Completed**

16.1 N/A.

17 **Forward Plan Reference**

17.1 N/A.

18 **Key Decision**

18.1 N/A.

19 **Background Papers**

19.1 The following is a list of background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents which would disclose exempt or confidential information as defined by the Act:

File Ref:	Background papers are included as Appendices 1 and 2
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20 **Appendices**

20.1 The following Appendices are available to support this Report:

- **Appendix 1:** FRC Position Paper - Restoring Trust in Audit and Corporate Governance, July 2022
 - **Appendix 2:** FRC Major Local Audits – Audit Inspection Report October
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