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Dear Mary

Grant Thornton update to audited bodies on the Financial Reporting Council's (FRC) report on local audit

Background to the report and FRC findings

On 30 October 2020, the FRC published its first annual report setting out the findings of its review of the work of local auditors. The report summarises the results of the FRC's inspections of fifteen audit files, across eight audit firms, for the financial year 2018/19. A link to the report is [here](#).

The FRC review covers the financial statements and Value for Money (VfM) work at major audits (broadly those with income or expenditure above £500m per annum). Non major audits have been reviewed by the Quality Assurance Department of the ICAEW (the QAD), and the results of these reviews are also summarised in the FRC report. This audit would fall into the definition of major local audit.

The FRC's key findings include the following:

- The standard of Value for Money work across all firms is high.
- The standard of non-major audit inspections completed by the QAD is also high.
- For the major audit inspections, firms need to improve the quality of their financial statements work. In particular, auditors need to demonstrate a greater degree of challenge and scepticism, especially around the critical judgements and assumptions in respect of complex estimates, including asset valuations, which the FRC states is important because it "*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 FRC reviewed six Grant Thornton files as part of its inspection, which was more than any other firm, due to the market share of our firm. The inspectors assessed one file as requiring limited improvements, and five of the six as requiring improvements. In each of the five cases where improvement was required, the FRC has highlighted the valuation of PPE as being the major area needing increased audit focus. No areas were assessed as 'significant improvements required'.

How we are responding to the FRC findings

The firm has responded in full to the FRC findings and our response has been published as part of the FRC report. The following are the key points to highlight for your attention:

- Grant Thornton are absolutely committed to audit quality and we welcome the review performed by

the FRC (along with comparable reviews performed by the ICAEW, Audit Scotland and Audit Wales) on our work.

- The FRC reviewed six VfM files. We are delighted to note that none of these had any more than limited improvements. The review feedback which we received from the QAD was similarly impressive. These are excellent results, and we are proud of the work we have delivered. Like Sir Tony Redmond, we believe that strong VfM work is at the heart of good local audit. We take VfM work seriously, invest time and resources in getting it right, and are not afraid to give difficult messages. In the last year alone, we have issued two Reports in the Public Interest at a major audit, as well as numerous Statutory Recommendations and Adverse VfM Conclusions. The inspection results, which the FRC have not included in this element of their report, illustrate how strong we are at VfM. With the new Code coming into effect for 2020/21, we have already updated and revised our approach, and will be training all our people in the new approach in the autumn.
- In terms of our work on the financial statements inspected by the FRC at major local audits, we recognise that we need to make improvements and are investing heavily to do so. We are also very mindful, when performing our work, that local authority auditors have different roles and responsibilities to commercial auditors, and that users of the local authority financial statements have different priorities from corporate shareholders.
- As regards our work on asset valuations, we are aware that the sector has raised the over-auditing of Property, Plant and Equipment (PPE) as a concern, as highlighted by Sir Tony Redmond. The FRC has given its view as our formal regulator, and we are required to abide by this. We therefore take those findings very seriously. Indeed, we have already undertaken extensive work over the past eighteen months to respond to previous comments made by the FRC and to implement our Quality Investment Plan in 2019, with a further update in 2020. This includes the fundamental reengineering of our approach to the audit of PPE, the increased use of auditor's experts for valuations, and an enhanced programme of training, guidance and support for our teams, all of which the FRC have been fully briefed on. It was not possible to have all of these changes fully in place for the 2018/19 financial year but arrangements are now in place for 2019/20. We will continue to drive further improvement as part of our ongoing commitment to quality and to address the FRC findings, which will require further audit work and challenge in this area.

Notwithstanding the above, we note the comments of Sir Tony Redmond in his recent inspection that where statutory adjustments apply, then *'these valuations have no immediate impact on the cost of delivering services or on the financial resilience of a local authority.'* We will work with CIPFA to help it develop alternative ways that local authority accounts can be presented.

Excluding PPE related findings, there were five other areas in which key findings were identified across six financial statements reviews at major local audited bodies. The FRC has also highlighted EQCR, fraud risk factors and completeness of expenditure as its other key findings.

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 of our ICAEW reviews. These results were excellent, with 6 out of 7 files assessed as requiring no or limited improvements. We will be keen to capture the learning from these including what went well and how we can build on this further.

Conclusions

The Financial Reporting Council inspected the 2017-18 audit of Devon County Council under contract from PSAA, two years ago, and we were satisfied with the outcome of this review. Recommendations arose from this review in relation to PPE valuations and have been built into subsequent audits of this Council in response to these findings.

Quality continues to be at the forefront of our agenda. We are proud of the work we have delivered on VfM and our QAD findings at non-major bodies but will look to build on our track record for VFM work with the introduction of the new NAO Code. In terms of the financial statements' inspection findings at major local audits, we will focus on driving through the changes which we consider are most fundamental to deliver better audit quality. We take the findings of inspectorates seriously, and the further investments we are making, including around additional work on PPE valuation, are an indicator of that. You will have already seen the results of this in 2019/20 and should notice further challenge, scepticism and even stronger audit quality as we undertake our 2020/21 audit.

Yours sincerely



Grant Thornton UK LLP