

Annual Regulatory Compliance and Quality Report

PKF (UK) LLP June 2013

Audit 2012/13

The Audit Commission's role is to protect the public purse.

We do this by appointing auditors to a range of local public bodies in England. We set the standards we expect auditors to meet and oversee their work. Our aim is to secure high-quality audits at the best price possible.

We use information from auditors and published data to provide authoritative, evidence-based analysis. This helps local public services to learn from one another and manage the financial challenges they face.

We also compare data across the public sector to identify where services could be open to abuse and help organisations fight fraud.

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Summary report

Introduction

- 1 The Audit Commission monitors the performance of all its audit suppliers. The results of our monitoring provide audited bodies and other stakeholders with assurance that auditors within our regime are delivering high-quality audits.
- 2 There are two strands to our 2012/13 monitoring:
 - audit quality- applying our annual quality review programme (QRP) to the audit work undertaken for the year ending 2011/12; and
 - regulatory compliance- reporting quarterly on audit suppliers' compliance with our 2012/13 regulatory requirements as set out in the Standing Guidance for Auditors.
- 3 The audit quality and regulatory compliance monitoring for 2012/13 incorporated a range of measurements and checks comprising:
 - the results of suppliers' compliance with 16 key indicators relating to Standing Guidance requirements;
 - a review of firms' systems to ensure they comply with the Commission's regulatory requirements;
 - a review of the firms' latest published annual transparency reports;
 - the results of reviewing a sample of each supplier's audit quality monitoring reviews (QMRs) of its financial statements, Value for Money (VFM) conclusions, Whole of Government Accounts (WGA) and Health Quality Accounts (HQA), certification and housing benefit (HB COUNT) work. Our review included assessing compliance with the Commission's certification instructions and HB COUNT guidance;
 - an assessment as to whether we could rely on the results of each firm's systems for quality control and monitoring;
 - a review of the Financial Reporting Council's (FRC) published report on the results of its inspection of the firm's audits in the private sector; and
 - the results of our inspection of suppliers by the FRC's Audit Quality Review team (AQR) as part of our commissioned rolling inspection programme. The scope of the FRC inspections goes beyond the audit of the financial statements to include: VFM conclusion, WGA, HQA and certification instruction work.
- 4 This report summarises the results of our monitoring work for PKF (UK) LLP (PKF).

Overall performance

5 The firm is meeting our standards for overall audit quality and our regulatory compliance requirements. We calculated the red, amber, green (RAG) indicator for overall audit quality and regulatory compliance using the principles detailed in Appendix 1. For 2012/13, the firm's combined audit quality and regulatory compliance rating was amber.

6 The firm has significantly improved its performance against the regulatory compliance indicators since last year, with all of the 2012/13 indicators scored as green. In addition, the firm has improved on its overall weighted audit quality score from last year.

7 However, because of one score of 0 on HB COUNT audit work the firm has been rated as amber for the combined audit quality and regulatory compliance indicator.

Detailed report

Quality review programme

FRC Inspection

8 Every year each firm provides a self assessment in the form of a statutory transparency report. Our review of the PKF transparency report did not highlight any significant issues of note.

9 Annually, the FRC publishes reports on the audit firms subject to full scope FRC inspections (including firms in our regime), as well as an overall annual report. We place reliance on the work of the FRC, which reviews the firms' systems and processes for ensuring audit quality and reviews a sample of their audits of public interest entities. In its latest public report (2012) on the firm, the FRC concluded that audit procedures were performed to a good or acceptable standard for all seven of the audit engagements reviewed, with no audits requiring significant improvement.

10 In addition, the FRC produces an annual overview report on the profession based on its audit quality inspection activities in the year. The FRC's overall conclusion in this report was that there was 'an improvement in the standard of audit work subject to our inspections...' (FRC Annual Report 2012/13, May 2013).

11 The FRC have identified a number of key issues which, profession wide, should be addressed in order to improve audit quality. Key issues included:

- a need for greater professional scepticism;
- a clear focus on audit quality in the face of economic pressure to cut costs;
- ensuring auditor independence;
- better group audit considerations; and that
- internal audit quality monitoring processes often showed more positive results than its inspection findings, recommending that firms reconsider the robustness of their monitoring processes and the extent to which they contribute to an improvement in overall audit quality.

12 We have previously raised a number of these issues with PKF, and with all other firms in our regime; and we will continue to monitor progress in these areas.

QMR programme

13 The Commission sets quality standards for its appointed auditors and monitors their performance against them. The principal means of monitoring and evaluating the quality of auditors' work is the annual QRP. For 2012/13 we relied on suppliers' own quality monitoring arrangements.

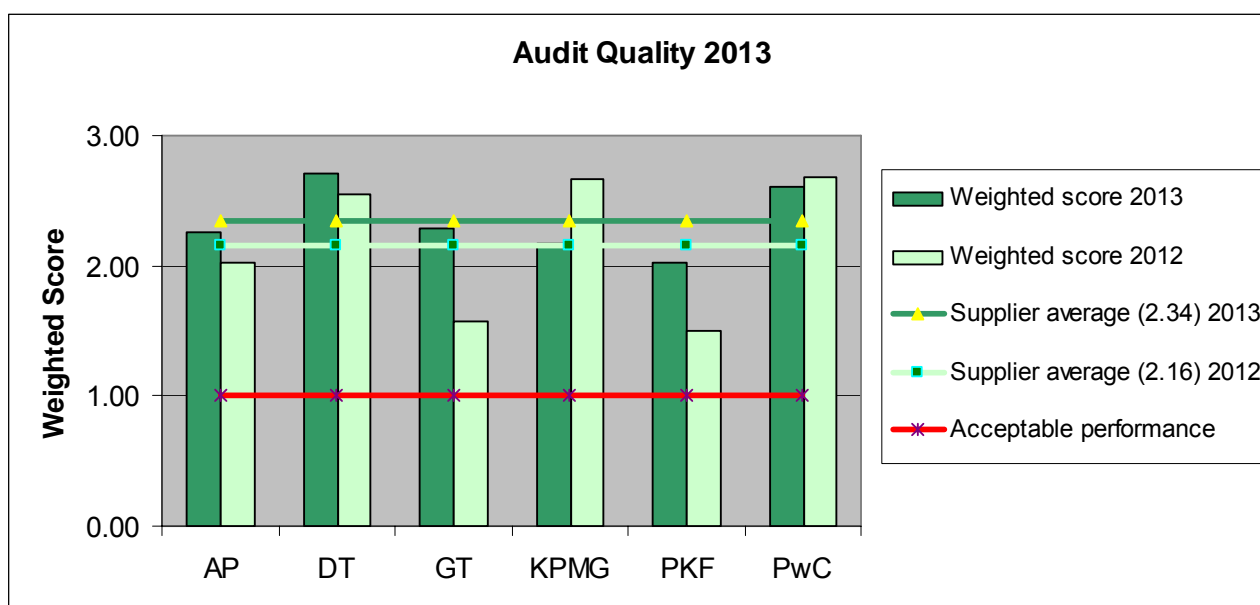
14 All our suppliers agreed to follow the Commission's methodology and reporting format for their QMRs for WGA returns, VFM conclusions, HQA, certification and HB COUNT audit work and use their own methodology for assessing work on the financial statements (converting the financial statements results to our scoring system). We concluded that the firm's QMRs were sufficiently detailed and rigorous for us to place reliance on all of the reviews provided by the firm.

15 All suppliers scored their QMRs using a common four-point scale, with 3 being the highest and 0 being the lowest. A score of 1 is our benchmark for acceptable performance. We calculated the score for overall audit quality on a weighted assessment using the weightings detailed in appendix 1.

16 The firm's score was 2.02, compared to an all supplier average of 2.34. This was an improvement on last year's score of 1.50.

17 Figure 1 shows the assessments of the firm's overall audit quality performance in comparison to other suppliers.

Figure 1: **2013 Comparative performance for audit quality**



18 For 2013, we have implemented a new methodology for reporting the results of our QRP programme. The methodology is designed to highlight any specific weaknesses at individual file level, specifically where our benchmark score of 1 was not met, which may have ordinarily been masked behind a high average score across the various elements (Financial statements, VFM, WGA, CI, HB COUNT and HQA) of the QRP.

19 We have calculated a red, amber, green (RAG) indicator for each element of the QRP, using the principles detailed in Appendix 2, as well as for overall audit quality. Where a supplier scores an average of less than 2, or has any scores of 0, a rating higher than amber in that element is not possible.

20 For 2012/13, the firm's overall rating for audit quality was amber because of a score of 0 awarded on one HB COUNT audit review. We consider each of the individual elements making up this rating below.

Financial statements audit work

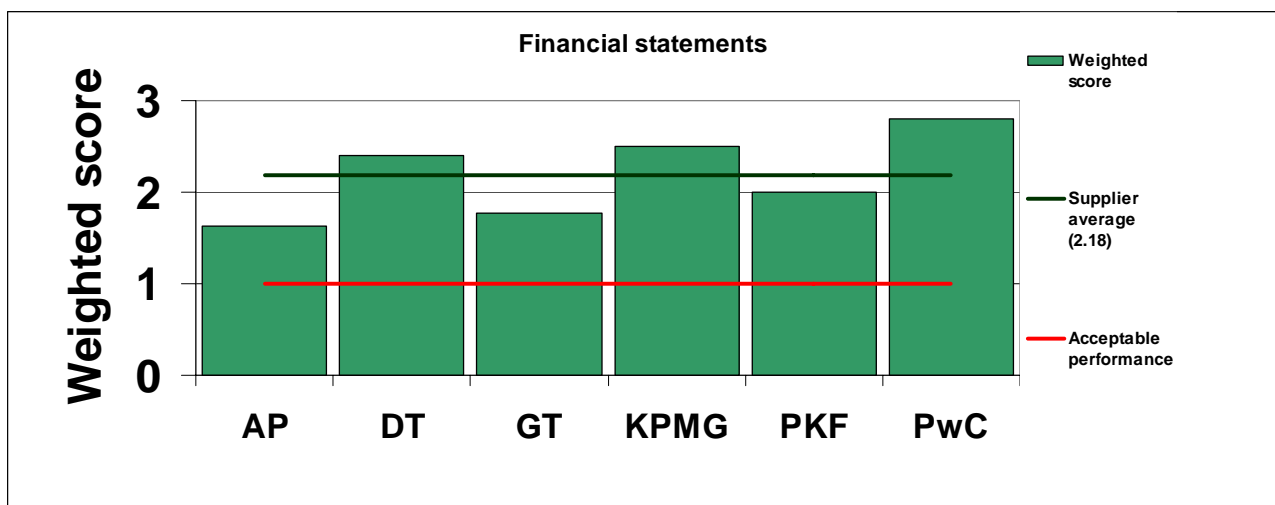
21 The firm provided the results of two QMRs for financial statement audit files. We reviewed the result for both of these files and agreed with the firm's assessments.

22 The improvement areas from these individual QMRs included:

- ensuring sufficient audit procedures are performed and documented on file in relation to the accounting treatment of investment properties; and
- ensuring there is sufficient consideration of the impact of prior year misstatements.

23 Figure 2 shows the comparative performance for financial statement audit work based on the results of the QMRs. The firm's average score was 2.0 compared to an all-supplier average of 2.18.

Figure 2: 2013 Comparative performance on financial statements work



24 For 2012/13, the firm's rating for financial statements work was green.

Whole of government accounts returns

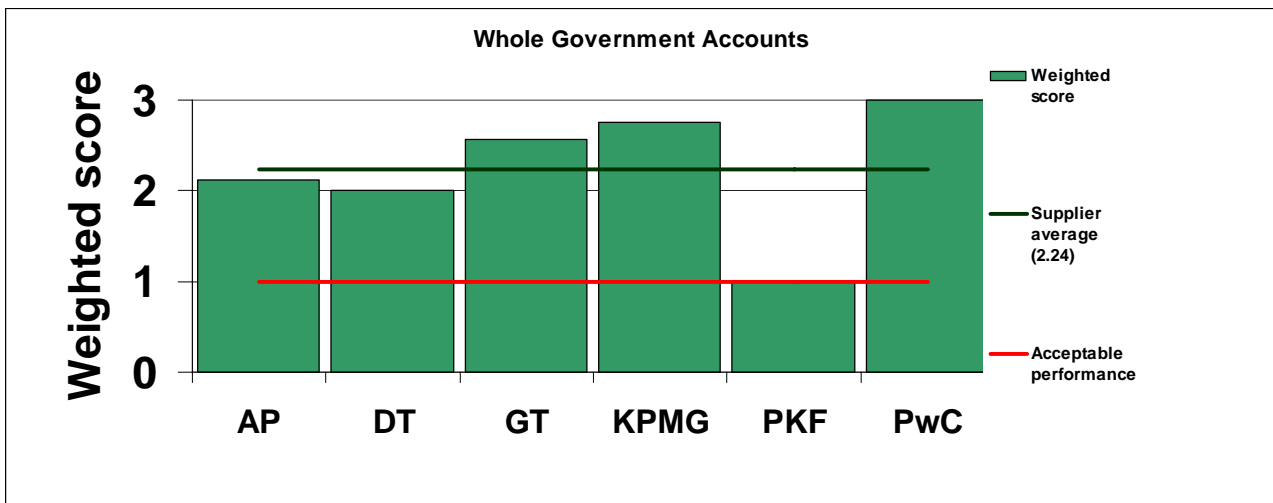
25 The firm provided the results of one QMR for WGA returns. We reviewed this and agreed with the assessment.

26 The improvement areas from this individual QMR included:

- ensuring that the WGA L-Packs are reconciled, line by line, to the primary statements and notes.

27 Figure 3 shows the comparative performance for WGA return audit work based on the results of the QMRs. The firm's average score was 1.00 compared to an all supplier average of 2.24.

Figure 3: 2013 Comparative performance on WGA work



28 For 2012/13, the firm's rating was amber because of the relatively low score on WGA work.

VFM conclusion audit work

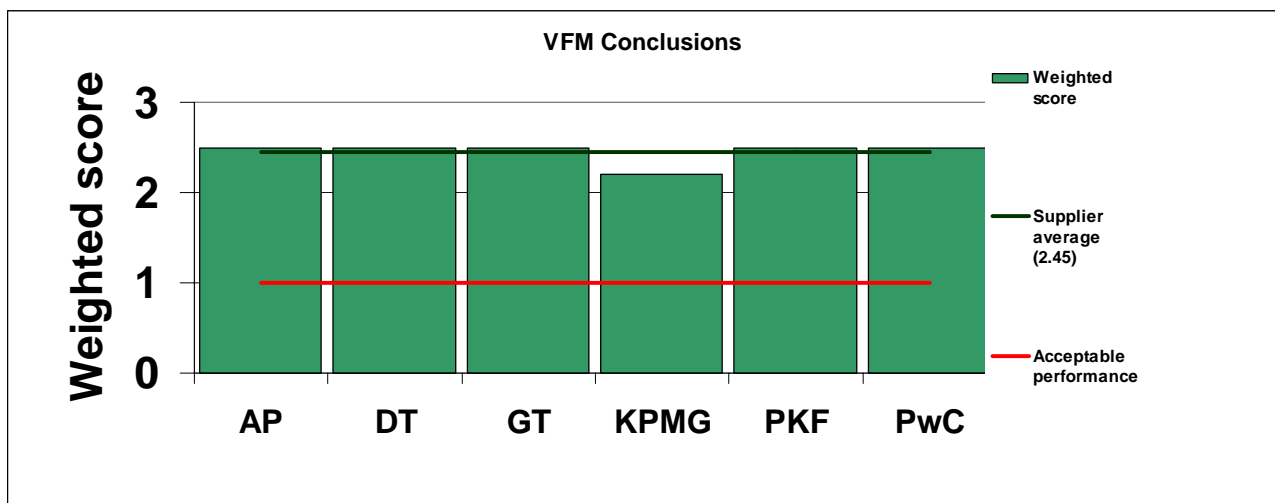
29 The firm provided the results of two QMRs for VFM conclusion audit files. We reviewed the results and agreed with both of the assessments.

30 The improvement areas from these individual QMRs included:

- improving the documentation on VFM conclusion audit files of risk assessment and linkage to audit evidence.

31 Figure 4 shows the comparative performance for VFM audit work based on the results of the QMRs. The firm's score was 2.50 compared to an all-supplier average of 2.45.

Figure 4: **2013 Comparative performance for VFM conclusion audit work**



32 For 2012/13, the firm's rating for VFM conclusion work was green.

Health Quality Accounts

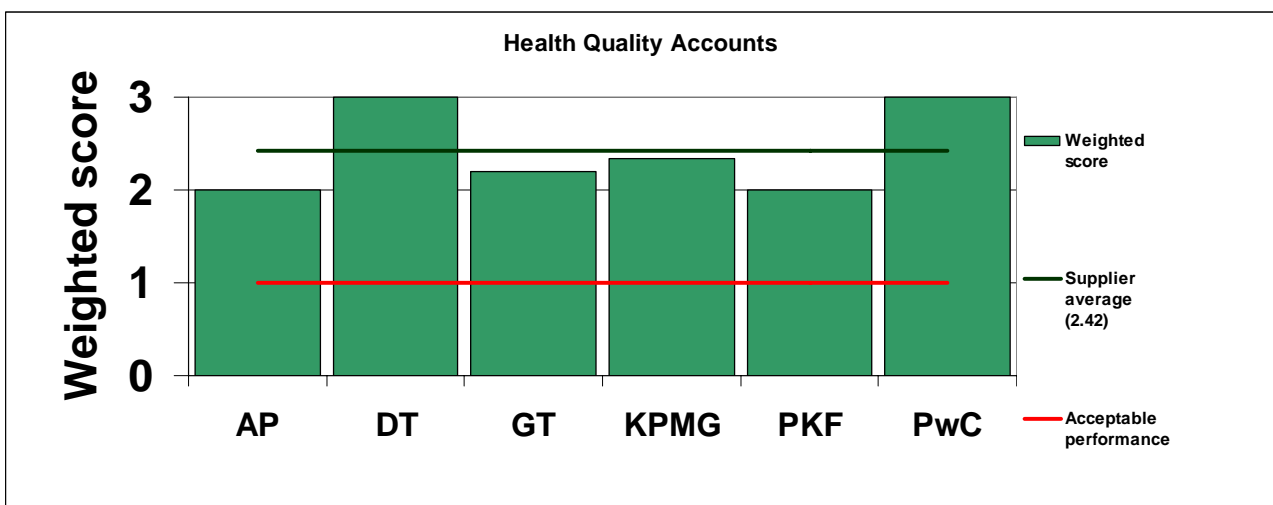
33 The firm provided the results of one QMR for a HQA assessment. We reviewed this and agreed with the score for the assessment.

34 The improvement areas from this individual QMR included:

- ensuring that the audit files explain how the samples tested linked to the overall HQA indicators reported; and
- improving the evidence on file of the engagement lead's review of the HQA work.

35 Figure 5 shows the comparative performance for HQA audit work based on the results of the QMR. The firm's average score was 2.00 compared to an all supplier average of 2.42.

Figure 5: 2013 Comparative performance for HQA audit work



36 For 2012/13, the firm's rating for HQA work was green.

Certification of claims and returns

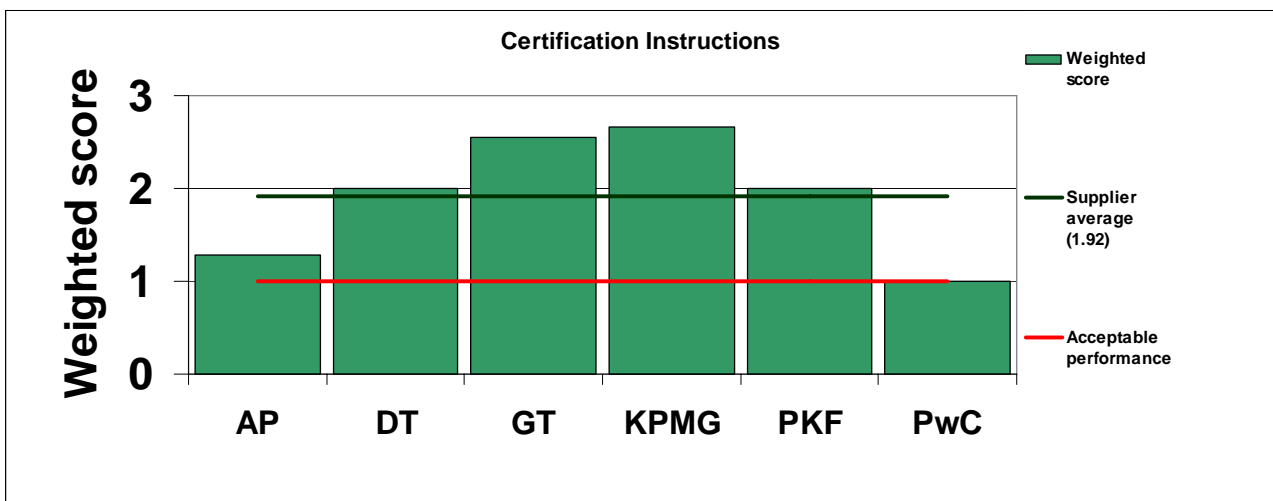
37 The firm provided the results of two QMRs for certification work (excluding HB COUNT work). We reviewed the results of these and we agreed with the firm's assessments.

38 The improvement areas from these individual QMRs included:

- improving documentation on reliance placed on other audit work in the Control Environment and Testing Assessment form for claims testing; and
- improving documentation on the audit file detailing sampling techniques and sample sizes for claims testing.

39 Figure 6 shows the comparative performance of each supplier based on the QMRs. The firm's average score was 2.00 compared to an all-supplier average of 1.92.

Figure 6: 2013 Comparative performance for Certification Instruction work



40 For 2012/13, the firm's rating for certification instruction work was green.

Housing benefit work

41 Each year auditors certify, as agents of the Commission, local authority claims for housing and council tax benefit subsidy to the Department for Work and Pensions (DWP). They are required to undertake this work using the Commission's guidance and tools (HB COUNT) which are agreed annually with the DWP. HB COUNT sets out the approach and work needed to certify the subsidy claim form. It includes a requirement to test a sample of cases to check that benefits have been awarded in accordance with benefit regulations and that subsidy has been properly claimed.

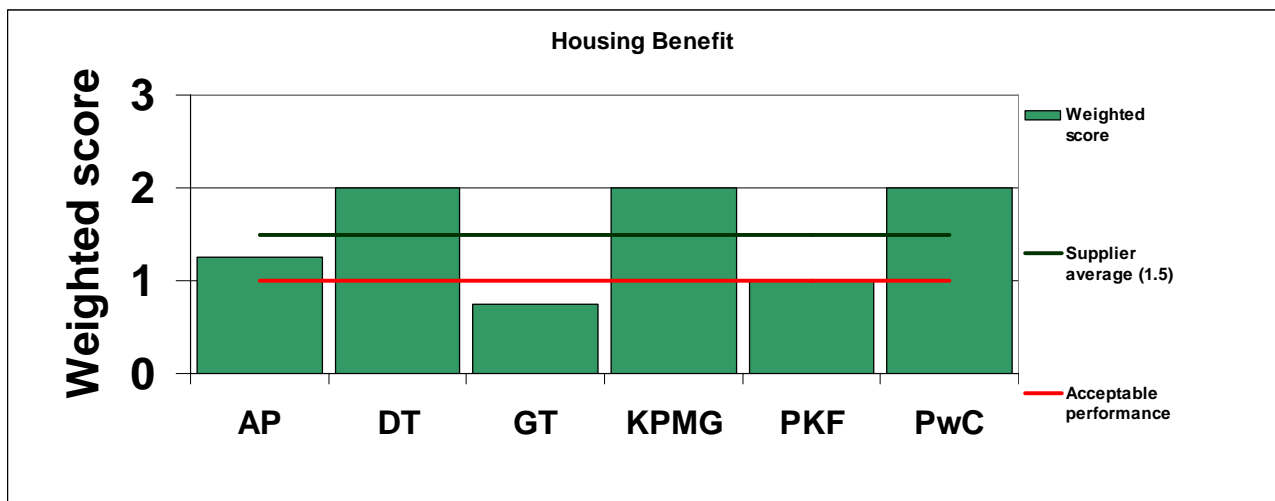
42 The firm provided the results of two QMRs for HB COUNT audit work. We reviewed the results of these and we agreed with the firm's assessments.

43 The improvement areas from these individual QMRs included:

- ensuring compliance with the Commission's instructions on housing benefit work, particularly around the documentation of the establishment of the validity of housing benefit claims.

44 Figure 7 shows the comparative performance of each supplier based on the QMRs. The firm's average score was 1.00 compared to an all supplier average of 1.50.

Figure 7: 2013 Comparative performance for HB COUNT audit work



45 For 2012/13, the firm's rating was amber because of the relatively low score; and one score of 0 awarded on HB COUNT audit work.

Regulatory compliance

Systems for compliance with our regulatory requirements

46 We tested the firm's systems and procedures for ensuring compliance with our regulatory requirements. We also examined evidence of how the systems were working and identified limited improvements to systems. Our conclusion was that we could place reliance on the firm's systems and procedures for monitoring compliance with our regulatory requirements.

Quarterly monitoring of our regulatory requirements

47 We reported the details in the quarterly monitoring reports issued to the firm during the year. Figure 8 details the firm's overall regulatory compliance RAG rating compared to other suppliers.

Figure 8: **2013 Comparative performance for regulatory compliance**

AP	DT	EY*	GT	KPMG	Mazars*	PKF	PwC
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*the 2012/13 regulatory compliance requirements were partly applicable to these firms from September 2012 when they joined the Audit Commission regime. The QRP will apply to these firms following completion of 2012/13 audits.

48 The firm performed well across all of our regulatory compliance requirements, with all of the 16 indicators being rated as green. We have included a summary at Appendix 3 of the results of the 2012/13 regulatory compliance monitoring RAG ratings, comparing the firm's performance against the overall performance for all suppliers.

Recommendations

Recommendations arising from the 2012/13 quality review programme

49 The firm has implemented most of the recommendations made in last year's report.

50 The key areas for improvement identified this year from file reviews are noted below, as taken from the body of this report:

Financial statements

- ensuring sufficient audit procedures are performed and documented on file in relation to the accounting treatment of investment properties; and
- ensuring there is sufficient consideration of the impact of prior year misstatements.

WGA

- ensuring that the WGA L-Packs are reconciled, line by line, to the primary statements and notes.

VFM

- improving the documentation on VFM conclusion audit files of risk assessment and linkage to audit evidence.

HQA

- ensuring that the audit files explain how the samples tested linked to the overall HQA indicators reported; and
- improving the evidence on file of the engagement lead's review of the HQA work.

CI

- improving documentation on reliance placed on other audit work in the Control Environment and Testing Assessment form for claims testing; and
- improving documentation on the audit file detailing sampling techniques and sample sizes for claims testing.

HB

- ensuring compliance with the Commission's instructions on housing benefit work, particularly around the documentation of the establishment of the validity of housing benefit claims.

51 Appendix 4 provides details of the actions the firm has, or intends to take to address these improvement areas. We understand the findings from the QMR will be considered by the firm's leadership group and then communicated to staff.

Appendix 1 – Weightings to calculate overall quality score

Audit element	Local government %	NHS	
		Trusts %	PCTs/SHAs %
Financial statements	55	60	65
WGA	3	n/a	n/a
VFM	30	30	35
Conclusions			
HQA	n/a	10	n/a
Certification Instructions	6	n/a	n/a
HB	6	n/a	n/a
Total	100	100	100

Appendix 2 - Audit quality and regulatory compliance RAG rating

QRP elements of financial statements, VFM conclusions, WGA assessments, health quality accounts, certification instructions and housing benefit work.

Rating	Firm level: Overall Audit Quality score	Firm level: Individual QRP element
Green	Firm audit quality score ≥ 2 and no scores of '0' at file review level	Average element score ≥ 2 and no scores of '0' at file review level
Amber	Firm audit quality score ≥ 1 with up to two scores of '0' at file review level	Average element score ≥ 1 with up to one score of '0' at file review level
Red	Firm audit quality score < 1 , or Firm audit quality score ≥ 1 but three or more scores of '0' at file review level	Average element score < 1 , or Average element score ≥ 1 but two or more scores of '0' at file review level

Regulatory compliance RAG rating based on 16 quarterly monitoring indicators

Rating	Overall firm level score- indicators
Green	12 or more at green and no more than two at red.
Red	Six or more indicators at red.
Amber	Neither green nor red.

Combined audit quality and regulatory compliance RAG

		QRP RAG		
		Red	Amber	Green
Regulatory compliance RAG	Red	R	R	A
	Amber	R	A	A
	Green	A	A	G

Appendix 3 - Results of 2012/13 regulatory compliance monitoring

Activity	Target	All suppliers % (no).	PKF % (no).	Red, amber, green (RAG) status
Number of audit opinions issued – NHS.	100% issued by 11 June 2012.	98.1 (5)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of VFM conclusions issued – NHS.	100% issued by 11 June 2012.	98.5 (4)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of audit opinions issued– local government and probation.	100% issued by 25 June and 30 September	98.0 (11)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of VFM conclusions issued - local government and probation.	100% issued by 25 June and 30 September	97.6 (13)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of WGA returns issued.	100% issued by 5 October 2012.	96.9 (14)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Confirmation of final fee reported to audited body – NHS.	100% by 26 October 2012.	100	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.

Activity	Target	All suppliers % (no).	PKF % (no).	Red, amber, green (RAG) status
Number of annual audit letters issued – NHS.	100% issued by 26 October 2012.	99.3 (2)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Confirmation of final fee reported to audited body – local government and probation.	100% by 26 October 2012.	98.0 (11)	93.3 (1)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of annual audit letters issued - local government and probation.	100% by 26 October 2012.	98.2 (10)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of planning letters issued – all sectors.	100% issued to audited bodies by 4 January and 28 March 2013.	100	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of certified claims and returns.	100% submitted by the relevant deadlines.	98.9 (14)	98.0 (1)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Submission of data returns to the Commission by the required deadline.	100% submitted by the relevant deadlines.	99.0 (54)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Assessment of the quality of the submitted data returns.	Quality and accuracy of submitted data returns.	98.4 (113)	99.4 (1)	G >95.01% or 1 not at required quality level. A 90.01 - 95.00% or 2 not at required quality level. R <90.00% or 3 not at required quality level.

Activity	Target	All suppliers % (no).	PKF % (no).	Red, amber, green (RAG) status
Number of complaints upheld against auditors.	No complaints upheld against auditors.	0	0	G = 0 upheld A = 1 R = 2 or more
Number of instances of non-compliance with standing guidance requirements on independence issues.	No instances of non-compliance with standing guidance	13	0	G = up to 1 A = 2 R = 3 or more
Attendance of Contact Partners (or appropriate representative) at Auditors' Group, Auditors' Group sub groups/technical groups.	No meetings missed.	5	0	Firm: G = up to 2 meetings missed A = 3 meetings missed R = 4 or more meetings missed Regime: G = up to 7 meetings missed A = 8 meetings missed R = 9 or more meetings missed

Appendix 4 - Summary of regulatory compliance and QRP improvement areas

Area	Improvement required	Firm response
Regulatory compliance	None	N/A
FRC annual report	<p>A need for greater professional scepticism;</p> <p>A clear focus on audit quality in the face of economic pressure to cut costs;</p> <p>Ensuring auditor independence;</p> <p>Better group audit considerations; and</p> <p>Internal audit quality monitoring processes often showed more positive results than its inspection findings, recommending that firms reconsider the robustness of their monitoring processes and the extent to which they contribute to an improvement in overall audit quality.</p>	<p>Professional scepticism - the firm has taken a number of actions to embed the application of professional scepticism. These include tone from the top communications, training and detailed guidance for partners and staff, and development of our audit documentation.</p> <p>Focus on audit quality – a focus on quality is being driven by the Leadership Team and this has been communicated to all partners during strategy workshops with appropriate messages around maintenance of audit quality at all times.</p> <p>Following the completion of the BDO/PKF merger, the firm has an enlarged Technical Standards Group which is actively underpinning this. Audit Summit and other internal courses have a strong focus on quality and mandatory technical training. For work in specialist areas, Responsible Individuals are licensed.</p> <p>Auditor independence – we have undertaken a review and updated our independence guidance.</p> <p>An independence workbook has been developed to help</p>

		<p>audit teams document independence threats, safeguards and approvals.</p> <p>These developments are underpinned by training and internal communications.</p> <p>Group audit considerations – we have undertaken training and developed further guidance to emphasise the revised requirements in respect of group audits.</p> <p>Internal audit quality monitoring – for the 2012 internal audit quality reviews further processes were introduced to ensure consistency of approach and on the basis of findings.</p>
Financial statements	<p>Ensuring sufficient audit procedures are performed and documented on file in relation to the accounting treatment of investment properties; and</p> <p>Ensuring there is sufficient consideration of the impact of prior year misstatements.</p>	<p>These matters were included in a Technical Update training session given to senior staff in April 2013.</p> <p>Our programme of reviews for audit files and accounts for 2013 audits includes a review of these aspects.</p>
WGA	<p>Ensuring that the WGA L-Packs are reconciled, line by line, to the primary statements and notes.</p>	<p>Key messages from the most recent QCR, including this one about WGA, were included in a Technical Update training session given to senior staff in April 2013. In addition, we will schedule a detailed training session for July/August 2013 (dates currently being researched) specifically for those staff involved in WGA audit for 2012/13.</p>
VFM conclusions	<p>Improving the documentation on VFM conclusion audit files of risk assessment and linkage to audit evidence.</p>	<p>Key messages from the most recent QCR including these about the quality of VFM conclusion files, were included in a Technical Update training session given to senior staff in April 2013. Our documentation for VFM conclusion work has been reviewed with these points in mind.</p>

HQA	<p>Ensuring that the audit files explain how the samples tested linked to the overall HQA indicators reported; and</p> <p>Improving the evidence on file of the engagement lead's review of the HQA work.</p>	<p>We held a targeted training session in February 2013 for all staff involved in HQA work for 2012/13.</p>
Certification instructions	<p>Improving documentation on reliance placed on other audit work in the Control Environment and Testing Assessment form for claims testing; and</p> <p>Improving documentation on the audit file detailing sampling techniques and sample sizes for claims testing.</p>	<p>Key messages from the most recent QCR, including these about certification instructions, were included in a Technical Update training session given to senior staff in April 2013.</p> <p>These specific points will be focused on in carrying out reviews of completed files for 2013.</p>
Housing benefit	<p>Ensuring compliance with the Commission's instructions on housing benefit work, particularly around the documentation of the establishment of the validity of housing benefit claims.</p>	<p>We received a train the trainer's session from the Audit Commission's internal expert in June 2013 and the senior staff that attended this session will be providing cascade training sessions which have been designated as mandatory for all staff involved in the delivery of this work.</p>