



Financial Reporting Council

DEVELOPMENTS IN AUDIT 2016/17

JULY 2017

High quality audit provides investors and other stakeholders with a high level of assurance that the financial statements of an entity give a true and fair view, and provide a reliable and trustworthy basis for taking decisions. Auditors carrying out high quality audit act with integrity and objectivity, are demonstrably independent and do not act in a way that risks compromising stakeholders' perceptions of that independence.

High quality audit complies with both the spirit and the letter of regulation and is supported by rigorous due process and quality assurance. It clearly demonstrates how it reflects investor and other stakeholder expectations, is driven by a robust risk assessment informed by a thorough understanding of the entity and its environment, and provides challenge, transparency and insight in a clear and unambiguous way.

High quality audit provides a strong deterrent effect against actions that may not be in the public interest, underpins stakeholder confidence, and drives continuous improvement.

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The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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SUMMARY REPORT

2016/17 was our first year as the designated Competent Authority for Audit, which has increased our responsibilities and enhanced our powers. The FRC has a strategic objective to promote justifiable confidence in UK audit. Such confidence is underpinned by the commitment of auditors to deliver high quality audit and focus on continuous improvement, as well as a commitment by companies to the highest standards of corporate governance and financial reporting.

Our assessment of the quality of UK audits results from our audit monitoring activity, which gives us a unique insight into the quality of individual audits of public interest entities (PIEs), and from the outcome of detailed thematic reviews focused on particular aspects of the PIE audit firms and their audit practices. This is supported by information from the professional bodies about their inspections of non-PIE audits and lessons learned from our enforcement activity. We also consider a range of other perspectives, including our survey of Audit Committee Chairs and the broader insight we gain from our interactions with UK and international stakeholders, including from the investor community.

There is evidence from these sources of improving audit quality and a commitment to continuous improvement.



Evidence from audit monitoring

The key message from our audit monitoring activity in 2016/17 is that the overall standard of audit work being done for FTSE 350 companies in the UK is improving. Audit opinions are reached independently and are generally well supported by audit work. There is evidence of continuous improvement, particularly for larger audits. However, a higher proportion of audits we reviewed outside the FTSE 350 main market required more than limited improvements. As a result we report no overall change in audit quality across all the audits we reviewed in 2016/17. Across all audits, outcomes are inconsistent between the firms, with areas of identified good practice such as enhanced quality control procedures also often those areas where there is most room for improvement.

Through our audit inspections we observe significant investment in programmes of improvement, and have seen examples of good quality procedures demonstrating:

- Greater involvement of senior team members in key aspects of the audit, including in the planning and review processes;
- A greater focus by firms on continuous improvement and root cause analysis when things go wrong;
- Firms also conducting root cause analysis when things go right, which we believe to be a powerful tool for identifying good practice to disseminate more widely;
- A high standard of design and direction of the component auditors' work over significant risks; and
- Situations where auditors have demonstrated greater scepticism when evaluating management assumptions and estimates.

AQR Inspection Results: FTSE 350

Audits assessed as either good or only requiring limited improvements¹

2016/17	81%
2015/16	77%
2014/15	70%
2013/14	69%
2012/13	68%
2011/12	56%

AQR Inspection Results: non-FTSE 350²

Audits assessed as either good or only requiring limited improvements

2016/17	72%
2015/16	74%
2014/15	63%
2013/14	53%
2012/13	48%

However, the picture is not consistent across all firms, market sectors and audit procedures. High profile accounting failures, as well as the results of our audit monitoring, continue to identify cases where auditors have not met expectations. Whilst we see evidence of greater professional scepticism for example, this is also the area where we continue to find the greatest number of issues and problems with the way auditors are conducting their work.

Audit firm leaderships' focus on audit quality is a key driver of good audits and is vital to promoting a culture of continuous improvement. While the progress made by individual firms differs, all firms are investing in audit quality and have set out further action to improve to deliver sufficiently consistent quality outcomes. A strong commitment to continuous improvement is vital to meet and then exceed the target we have set to be achieved by the time of our 2018/19 inspections that for FTSE 350 audits at least 90% will require no more than limited improvement.

Audit firm leaderships' focus on audit quality is a key driver of good audits and is vital to promoting a culture of continuous improvement.

¹ Note that our inspection evidence can only ever be based on a sample of the audits conducted in any year. This means although the data suggests linear and continuous improvement, care should be taken when assessing the overall trend.

² The scope of these inspections includes listed companies outside the FTSE 350, including large AIM and other Public Interest Entities including non-listed insurers, banks, building societies, Lloyd's syndicates and mutuals.

The Recognised Supervisory Bodies (**RSBs**) also carry out audit inspections, with changes in results broadly consistent with our own.

RSB Monitoring Visits ³	2014	2015	2016
Audit files receiving the highest grade	18%	18%	21%
Audit files receiving the lowest grade	17%	18%	13%

Other perspectives of audit quality

Our view of continuous improvement is supported by the results of our YouGov survey of Audit Committee Chairs which shows a further marginal increase in confidence about the quality of audits being done for Public Interest Entities (PIEs).⁴

What has been done to promote continuous improvement in audit quality?

Retendering and Rotation

Changes to the rules relating to audit tendering and rotation have put differentiation on the grounds of quality at the heart of competition between the firms. Stakeholder feedback suggests that new auditors are bringing fresh challenge and new perspectives for companies that have previously retained an incumbent auditor for some considerable time. The evidence we have suggests that whilst the Big Four audit firms continue to dominate the FTSE 350 audit market, there has been greater competition based on quality between the firms within that market. There is no evidence to suggest that competition has led to a simple downwards pressure on audit fees.

In total 213 (61%) of the FTSE 350 have announced they have completed a tendering exercise in the past 6 years. 74% of tenders have resulted in the appointment of a new audit firm.

Overall, the Big Four firms have increased their total share of FTSE 350 audit market from 95% to 97% (based on number of audit clients).

2015 and 2016 are likely to represent peak years in the short term for the number of audit tenders as the initial impact of the policy changes works through – with approximately 50 tenders in the FTSE 350 in 2015 and 70 in 2016.

Greater Transparency

The simultaneous reforms we introduced in 2012 to the Corporate Governance Code and to Auditing Standards continue to help drive better quality financial reporting and make audit more transparent. The UK was one of the very first capital markets to introduce an Extended Auditor's Report, alongside extended Audit Committee reporting, which has been broadly welcomed by the users of financial statements, and is now being taken up in the international auditing standards and in the US. The UK audit firms have innovated in the first 3 years, starting from the basic principles and requirements we set and generally avoiding boilerplate or overly technical descriptions of their audits. As these reports now become commonplace outside the main listed market in the UK we will continue to monitor progress and encourage further innovation and responsiveness to the needs of users. Investors tell us there is appetite for more innovation and insight.

Broadened Perspectives of Quality

In recent years the FRC has shifted focus to help sustain ongoing improvements in the quality of UK audit. We have increased the number of individual inspections we carry out, and now communicate more

Changes to the rules relating to audit tendering and rotation have put differentiation on the grounds of quality at the heart of competition between the firms.

³ The scope of RSB inspections includes the audit of non-PIE entities. See the section in the detailed report on our professional oversight activity for more specific detail. Caution should be exercised when considering trends over time since the population of firms, and therefore audit files, reviewed each year differs because of the cyclical nature of the selection process.

⁴ For more detail see the main body of our report and the section setting out the role of the audit committee.

directly with Audit Committees about the results of our inspections and have set an expectation that Audit Committees in turn report on our findings. We have completed thematic reviews of areas where we believe there is an opportunity to enhance audit quality, for example data analytics and root cause analysis.

2016/17 thematic reviews

Firms' audit quality control procedures and other quality initiatives – quality is embedded better through strong leadership and the right firm culture. However, our wider monitoring work demonstrates that this improvement is still not yet sufficient to prevent poor inspection findings.

Root Cause Analysis – all firms have improved how they do root cause and it is now in widespread use. More training, greater consistency and more external perspective would drive greater improvements – as well as more use of root cause analysis when things go right as well as wrong.

The Use of Data Analytics – UK firms are at the forefront of developing analytics with the potential to improve audit quality. Their use in audits is not yet widespread.

We combine this with fuller engagement with the firms' leadership and Independent Non-Executives (INEs) to encourage continuous improvement. Our revised Audit Firm Governance Code focuses the role of the INEs on audit quality and requires there to be more and broader INE input. We see a greater focus by the firms on looking at the root causes of both good and poorer quality audits, and a commitment to embed lessons learnt into future practice.

Where will further improvement be focused?

Moving forward there are areas where we continue to have concerns or where there are risks to continuous improvement and we are focused on playing our part to address them.

Responding to Auditing Failures

However encouraging the overall trends in audit quality are, investor and wider public confidence in audit remains inherently vulnerable to evidence of inappropriate conduct by auditors and of poor audit work. This is particularly true where circumstances indicate a failure by auditors to be sufficiently independent of their clients, or to demonstrate the willingness and ability to provide robust challenge to management. We have enhanced our enforcement procedures to address cases where standards are not met. We also recognise that confidence is undermined if swift action is not taken in the face of wrongdoing or failure. We brought several cases to conclusion in 2016/17, and since then, and are working to conclude our cases quicker not just to ensure that we hold auditors to account but also to ensure that we are able to promote lessons learnt quickly. The leadership and continuous improvement culture of the audit firms has an important role to play. The level of cooperation received from firms under investigation varies considerably case by case and can have a significant impact on the efficiency of our investigations and our ability to express lessons learnt quickly. A separate section of our report describes in detail the outcomes and lessons to be learnt from our concluded investigations, as well as the list of open cases.

An independent panel will shortly advise on the effectiveness of the sanctions we apply in deterring poor quality and promoting high quality audit supporting public confidence.

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Quality Focused Culture

Our objective to see continuous improvement in the quality of audit in the UK, means that we will focus on practices which can ensure the greatest enhancements. Audit firm governance and culture, ensuring that the right tone is set from the top are a key focus. We continue to monitor how effectively the firms apply the Audit Firm Governance Code.

A thematic review of how the audit firms are promoting, measuring and assessing their own culture will be carried out in 2017/18, with a particular focus on the implications for audit quality.

We will continue with thematics given evidence that previous reviews have stimulated improvements across the firms. In 2017/18 we will follow up previous work in areas such as the auditor's application of the concept of materiality, as well as examining the consistency of their approach to the 'other information' included in annual reports.

Our focus in standard setting will be on underpinning continuous improvement through development of the international standards and guidance as well as our own. The IAASB's focus on a quality management approach resonates with our thinking.

Promoting Scepticism

At the heart of an effective audit is the demonstration by the auditor of an independent and sceptical mind-set, as well as the capacity for self-challenge. This is true of all aspects of the audit, but is perhaps most important when evaluating management's estimates. Failures by auditors to be sufficiently sceptical, and therefore independent and objective in the way they approach their work, continues to be a theme running through poorer quality audits identified in our inspections and in our enforcement cases. This is a particularly important area given the increasingly complex nature of accounting estimates, and recent and upcoming changes to International Financial Reporting Standards (IFRS).

Current proposed revisions to International Standards on Auditing (ISAs), and particularly to ISA 540 on the audit of management estimates, are designed to further embed a sceptical approach in the audit of management's estimates. We have been heavily involved in the work by the International Auditing and Assurance Standards Board (IAASB) to make these revisions.

Consistency of Execution

We intend to concentrate on the consistency of high quality execution in all audits. As a result of our current inspection cycle, we have an emerging concern about differential quality with improvements in large PIE audit quality potentially being at the cost of quality elsewhere. We will focus on the how the firms lead on quality – including the ongoing revisions to ISQC1 (the international quality control standard) which will embed a quality risk management approach. Our culture thematic will set out what audit firms are currently doing in this area and provide examples of good practice. Some firms, for example, are increasingly able to use technology and data to facilitate real-time audit quality monitoring across a range of indicators, such as timely planning and consistency of risk identification with industry expectations. We will monitor and encourage such developments.

More widespread use of data analytics and artificial intelligence software in the audit may also drive up audit quality. We are already engaging with the firms to identify the opportunities and challenges, including how compliance with auditing standards can be preserved. We will continue to highlight good practice.

Principles Based Auditor Independence

In our firm-wide work on systems of ethics and independence we observe higher levels of compliance. We have recently reviewed how the firms have addressed implementation of new requirements and it is clear that all firms have adopted a robust approach. However independence cannot be assured through rules.

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In applying the principles of our Ethical Standard, auditors should focus on the perspective of a reasonable, informed and objective third party. In a small number of instances investors have raised concerns that firms have sometimes applied a rules based mentality, resulting in a perception that the firm's interests have been promoted over the public interest. We will continue to engage with stakeholders and the firms to address such incidences and to develop market understanding as to how the principles of independence apply.

Impact of Rotation and Retendering

Rotation and retendering of the audit engagement enhances stakeholder confidence in audit, particularly in respect of the perceived independence of the auditor. Audit committees report that a fresh perspective brings benefits to audit and reporting quality. We have provided guidance to Audit Committees on the factors which can help ensure an effective tender process; one which embeds quality considerations and avoids disruption to the audit service. Audit Committees need to ensure they have allowed sufficient time to make the change, and that they have a clear strategy for procuring non-audit services.

Our analysis of the relationship between audit fee income and rotation of auditors does not provide conclusive evidence about whether fees are increasing or decreasing as a result. Firms report that the costs and challenges connected with tendering, as well as those related to taking on new clients with complex businesses are high. It is important that the audit firms devote sufficient resources and focus to ensure that these challenges are met. We monitor first year audit quality in our inspections, and we will also monitor, and as necessary give transparency to, concerns as to the impact on the sustainability of quality from audit fees.

Harnessing Technology

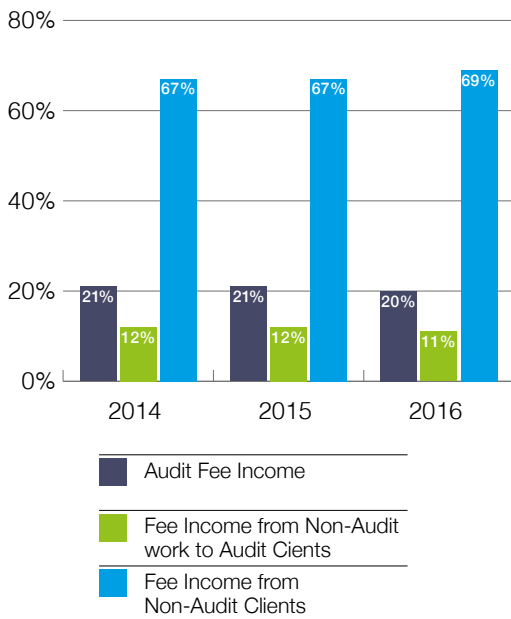
We recognise the significant opportunities and challenges ahead for the audit profession, including developments in technology and the related opportunities for innovation. We continue to engage with our stakeholders to ensure that the potential benefits and disbenefits of new technology are understood, and that our standards help auditors continue to improve the quality and relevance of their work. We intend to monitor risks relating to cyber threats, both from the perspective of audited entities and of the audit firms which handle significant and increasing amounts of client data.

Audit's Role in Multi-disciplinary Practices

We monitor and report on the relative importance of fees from audit and non-audit services for the major firms. The challenge is to ensure that audit remains at the heart of their businesses; a healthy and competitive audit market underpins the UK capital market. We will continue to monitor fees, to focus on how the firm's leadership and culture places sufficient emphasis on audit and ensures that the firm's reputation is not adversely affected by other lines of service.

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Graph 1: Analysis of Big Four Fee Income (2014-16)⁵



Impact of Global Networks

The audit firms recognise the impact of network issues on reputation and brand. The opportunities for efficiency and improved quality through technology makes investment globally imperative. We observe the firms adopting an increasingly global culture and approach, providing further oversight and challenge to domestic firms. Our culture thematic will explore how global firms impact on UK firm culture.

Finally, the FRC recognises that it is regulating domestic audit in a global market; emerging issues and problems in the global network firms have a knock on effect for the UK. We liaise closely with the firms to obtain evidence that they respond to these kinds of issues in an appropriate and timely way and have contingency plans in place. We liaise with other independent audit regulators internationally under individual Memorandums of Understanding and with European regulators in firm colleges to better identify and manage risks to audit quality.

Our in depth report

Developments in Audit provides a more in depth report of recent developments in the market, and where we fit in as the market regulator. The report provides detail about:

- The market context, including the size and reach of the largest audit firms and the impact of new requirements on audit tendering and rotation;
- The FRC and the regulatory environment, including a summary of our objectives, our strategy and our priorities for 2017-18;
- What we are doing, and what outcomes we see:
 - Setting auditing standards, codes and guidance; the Audit Firm Governance Code; and our work with international standard setters;
 - Promoting the effectiveness of Audit Committees to enhance audit quality, including the results of our survey of Audit Committee chairs on audit quality;
 - Monitoring audit quality, including an overall position and firm-by-firm information;
 - Overseeing the profession including our delegation to the Recognised Supervisory Bodies (RSBs)
 - Taking enforcement action, including the resolution of closed cases and ongoing investigations; and drawing out lessons learnt.

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⁵ Source: FRC, *Key Facts and Trends in the Accountancy Profession* (July 2017), p.41, Figure 32.

**DEVELOPMENTS
IN AUDIT
2016/17**

INTRODUCTION

The FRC has a strategic objective to promote justifiable confidence in UK audit. Such confidence is underpinned by the commitment of auditors to deliver high quality audit and focus on continuous improvement, as well as a commitment by companies to the highest standards of corporate governance and financial reporting.



Our assessment of the quality of UK audits results from our audit monitoring activity, which gives us a unique insight into the quality of individual audits of public interest entities (PIEs), and from the outcome of detailed thematic reviews focussed on particular aspects of the PIE audit firms and their audit practice. This is supported by information from the professional bodies about their inspections of non-PIE audits and lessons learned from our enforcement activity. We also consider a range of other perspectives, including our survey of Audit Committee Chairs and the broader insight we gain from our interactions with UK and international stakeholders, including from the investor community.

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The key message from our audit monitoring activity in 2016/17 is that the overall standard of audit work being done for FTSE 350 companies in the UK is improving. Audit opinions are reached independently and are generally well supported by audit work. There is evidence of continuous improvement, particularly for larger audits. However, a higher proportion of audits we reviewed outside the FTSE 350 main market required more than limited improvements. Across all audits, outcomes are inconsistent between the firms, with areas of identified good practice such as enhanced quality control procedures also often those areas where there is most room for improvement. As a result we report no overall change in audit quality across all the audits we reviewed in 2016/17.

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This report sets out the basis on which we make this assessment, and provides a summary of developments since July 2016 against our plan for 2016/17 to focus on:

- making a success of our competent authority status, in liaison with the Recognised Supervisory Bodies for audit (RSBs), to promote audit quality;
- working with auditors, Audit Committees and investors to communicate good practice and promote continuous improvement;
- underpinning confidence with sound and effective enforcement;
- continuing to promote audit quality internationally, recognising the international nature of UK markets and investment; and
- keeping pace with, and facilitating where possible, changes in audit and its use of technology in improving the effectiveness and quality of audit.

Importance of Audit

Investors and other users of financial statements rely on auditors to give them confidence that the information on which they base their economic decisions is true and fair, and that company annual reports are fair, balanced and understandable. Confidence in the financial information companies present to the market is fundamental to the functioning of our capital market, and to ensuring that the UK remains an attractive and competitive destination for international investment. High quality audit also provides a strong deterrent effect against actions which are not in the public interest.

The Audit Market in the UK

The most recent estimates by the Department of Business, Energy and Industrial Strategy (BEIS) suggests that approximately 93,000 companies in the UK are required to have their annual accounts audited.¹ The total market capitalisation of listed companies on the main market and AIM, all of which are subject to audit, is c.£4.2tr,²

£4.2tr

UK listed companies (Main and AIM market)
total market capitalisation (as at 31 May 2017)

There are approximately 5,800 registered statutory audit firms in the UK, and 23,000 registered statutory auditors.³

5,792

Current number of registered statutory audit firms in UK (30 June 2017)

23,026

Current number of registered statutory auditors (30 June 2017)

In 2015/16 UK audit firms with PIE clients generated £2.535bn in audit fees and a further £1.409bn in non-audit services to their audit clients. Although this is a significant revenue stream for the firms, they also had non-audit fee income to non-audit clients of £7.97bn, or 67% of their total income from professional services. Significantly, the 4 largest firms (PwC, KPMG, Deloitte, EY) earn around 80% of the total available fee income from audit clients, and 85% of fees from non-audit clients.⁴

1 Ref:BEIS ARD Impact Assessment. The requirements and exemptions are set out in the Companies Act 2006, <http://www.legislation.gov.uk/ukpga/2006/46/part/16/chapter/1/crossheading/requirement-for-audited-accounts>.

2 As at 31 May 2017. Source London Stock Exchange.

3 Register of Statutory Auditors, as at 30 June 2016, <http://www.auditregister.org.uk/Forms/Statistics.aspx>

4 Source: FRC, Key Facts and Trends in the Accountancy Profession (July 2017), p.37, Figure 31.

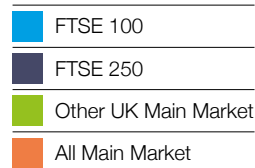
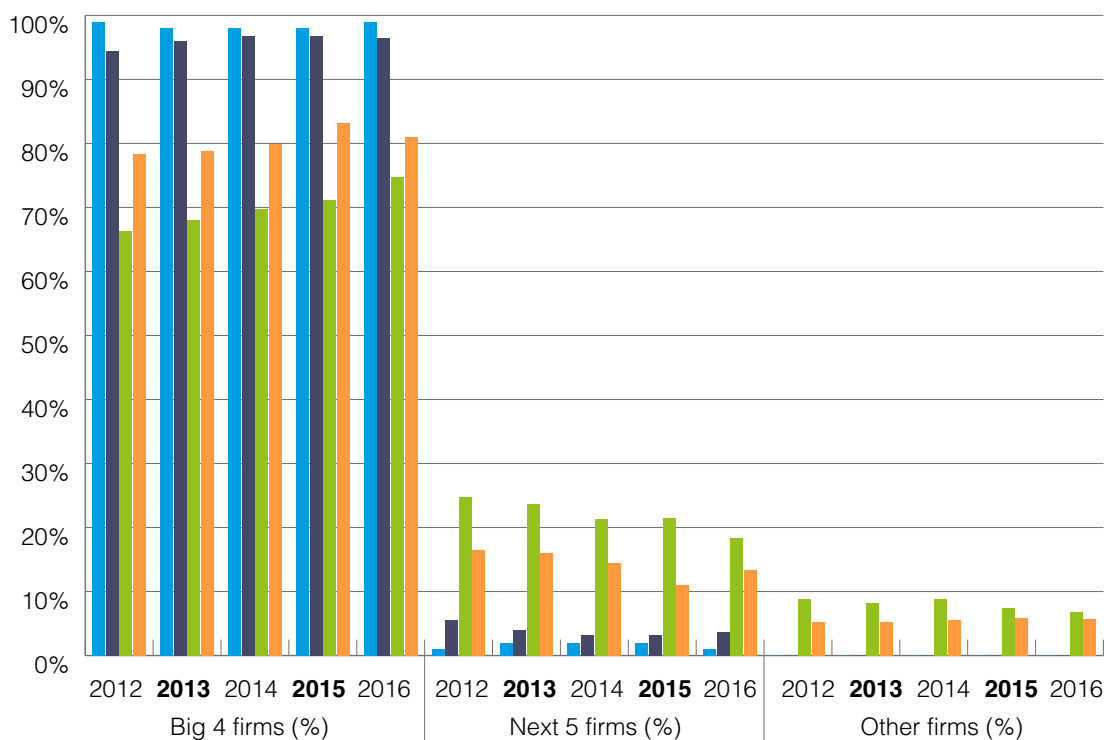
**Table 1⁵**

	£m	Big Four	Big Four %
Total Fee Income - Audit	2,535	1,972	78
Total Fee Income – Non-audit services to audit clients	1,409	1,114	79
Total Fee Income – Non-audit services to non-audit clients	7,970	6,786	85
Total Fee Income	11,950	9,872	83

As our analysis demonstrates the UK audit market remains highly concentrated across four firms, particularly for listed entities (99% of FTSE 100 audits; 96% of the FTSE 250; 75% of Other UK Main Market). Graph 2 below illustrates this dominance by each segment of listed audit clients:

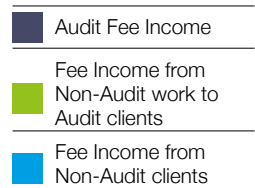
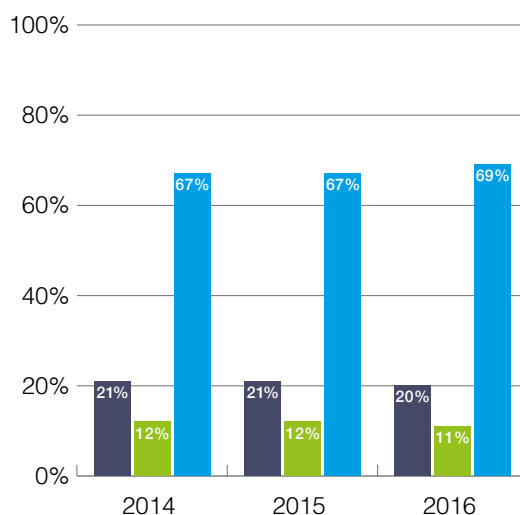
⁵ Source: FRC, Key Facts and Trends in the Accountancy Profession (July 2017), p.37, Figure 31.

Graph 2: % audit market share by number of audit clients⁶



In addition, particularly for those four firms, the relative importance of audit related fee income shows a small decline, and is dwarfed by fees for other work to non-audit clients.

Graph 3: Source of fee income for the Big Four UK audit firms⁷

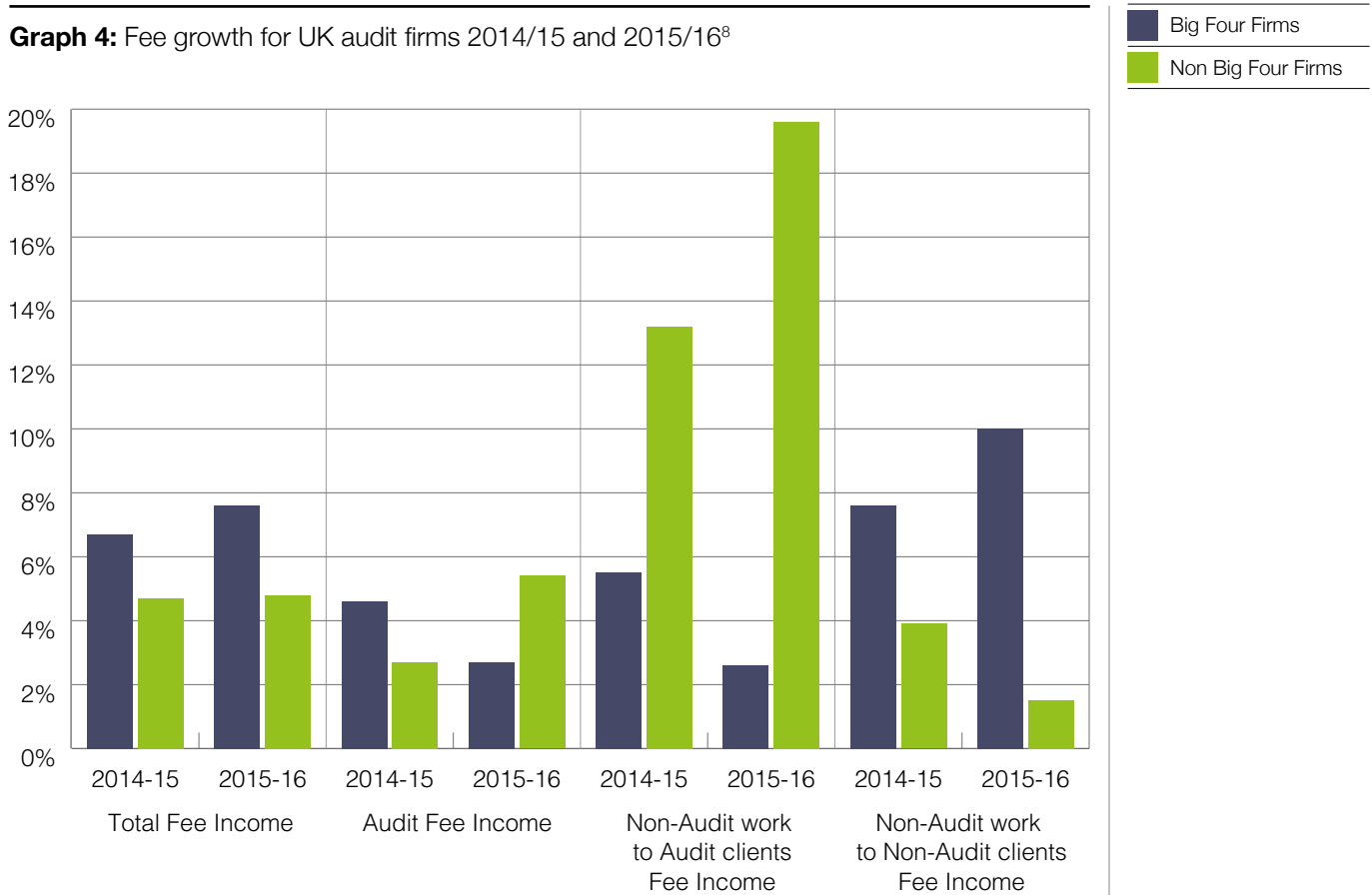


Although audit fees continued to grow overall between 2014/15 and 2015/16, graph 4 below demonstrates that firms outside the Big Four have increased their income from audit clients at a greater rate than the Big Four – for which fees unrelated to audit or audit clients grew at a much faster rate.

⁶ Source: FRC, Key Facts and Trends in the Accountancy Profession (July 2017), p.48, Figure 37.

⁷ Source: FRC, Key Facts and Trends in the Accountancy Profession (July 2017), p.41, Figure 32.

Graph 4: Fee growth for UK audit firms 2014/15 and 2015/16⁸



This trend is not unique to the UK market, with the global networks now providing a broad range of professional services with non audit revenue surpassing audit fee income.

Two of the consequences of this concentration in the market, and the balance between audit fees and non-audit fee income have particular resonance for audit regulators including the FRC:

- The potential impact on investor perception of audit firms' motivation and confidence in audit quality. This points to the critical importance of audit firm governance and culture to ensure, in the public interest, the highest standards of ethical behaviour.
- Market risk given the reliance on a small number of firms.

It is important for the health of the audit market in the UK that audit firms do not lose their focus on their audit

practices, and that they continue to invest in the quality of audit work being done. The evidence suggests that increased competition as a result of changes to the rules on audit tendering can drive innovation, greater efficiency and competition on the grounds of quality between the firms. There are also challenges, including ensuring that there remains a sustainable business model underpinning the audit practices, that audit continues to represent an attractive career path for talented professionals, and that audit has the appropriate amount of influence on the culture and governance of the firms. These are issues we engage on in an ongoing basis – including most recently our revisions to the Audit Firm Governance Code.

Concentration and lack of competition in the market were also factors of concern in the aftermath of the financial crisis in 2008, with the potential for over familiarity

⁸ Source: FRC, Key Facts and Trends in the Accountancy Profession (July 2017), p.43, Figure 34.

between auditors and their clients, as well as 'group think' amongst auditors, FRC concerns prompted a review into the FTSE350 audit market by the UK competition authority.

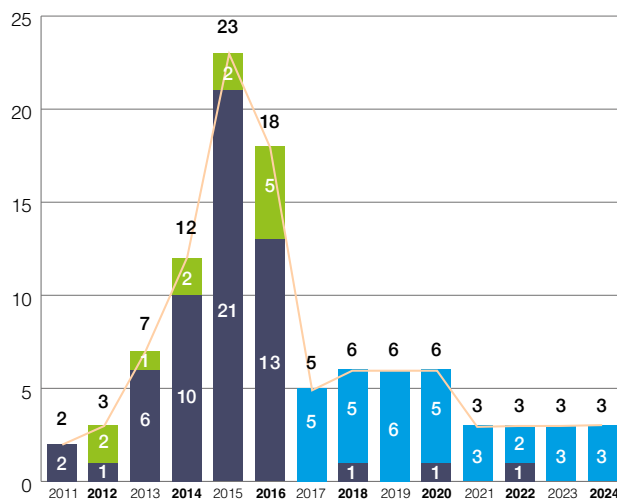
Subsequent reforms, including first through the UK Corporate Governance Code and then through the EU Audit Regulation and Directive (ARD), included the introduction of mandatory audit tendering and periodic rotation, as well as restrictions on services which could be provided to audit clients.

Experience suggests that changes to the rules on tendering and rotation have resulted in greater competition on the grounds of audit quality between the established Big Four, rather than increasing the number of audit firms competing for PIE audits. We reported in *Developments in Audit 2015/16* that when we reviewed detailed proposals from a sample of tenders in late 2015 we found evidence of a focus on audit quality which we had not seen in similar exercises in 2009 and 2011.⁹ A focus on underlying audit quality is underpinned by direct independent monitoring by the FRC. Transparency of our audit monitoring findings for each firm and now on engagements encourages competition on quality.

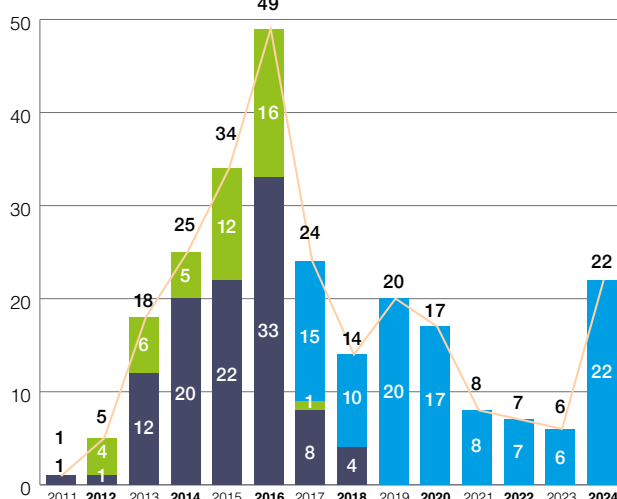
Audit Tendering and the FTSE 350

Analysis of published data on the FTSE 350 demonstrates that 2015 and 2016 are likely to represent initial peak years for the number of audit tenders as the initial impact of the rule changes works through.¹⁰

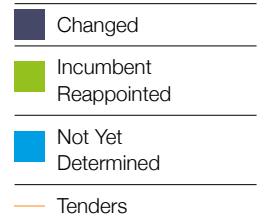
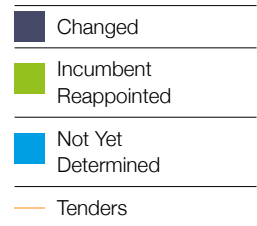
Graph 5: Tender activity - FTSE 100¹¹



Graph 6: Tender activity - FTSE 250¹²

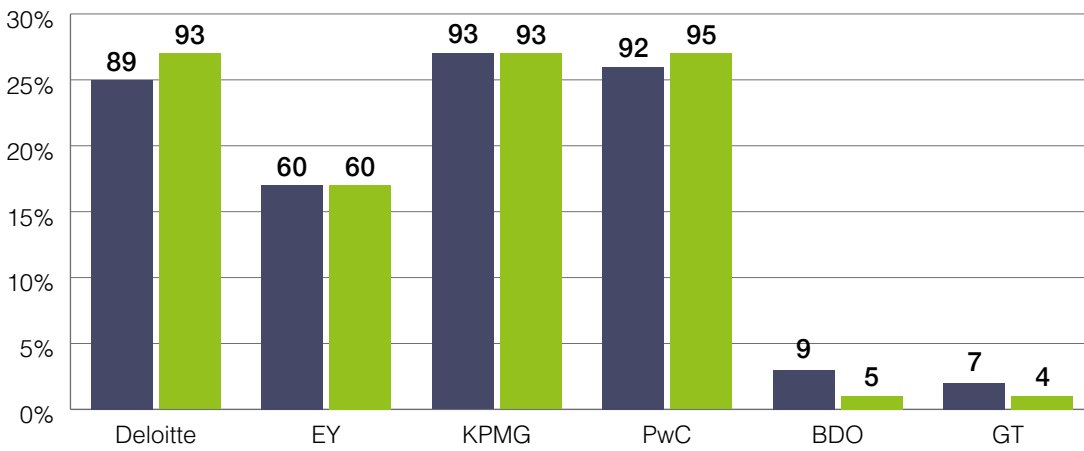


In total 213 (61%) of the FTSE 350 have announced they have completed a tendering exercise in the past 6 years. 74% of tenders have resulted in the appointment of a new audit firm. Overall, the Big Four firms have increased their total share of FTSE 350 audit market.¹³



9 *Developments in Audit 2015/16*, p.27.
 10 Assuming that companies chose to wait until the last year to have a further tender, then this 'peak' could potentially repeat in the mid-2020s.
 11 Analysis of data for the FTSE 100 as at 31st December 2016. We have used published sources. Where no announcement has been made about a future tender, then we have assumed the next tender will take place within 10 years.
 12 Analysis of data for the FTSE 250 as at 31st December 2016. We have used published sources. Where no announcement has been made about a future tender, then we have assumed the next tender will take place within 10 years.
 13 BDO and Grant Thornton are the only other 2 audit firms currently with FTSE 350 clients.

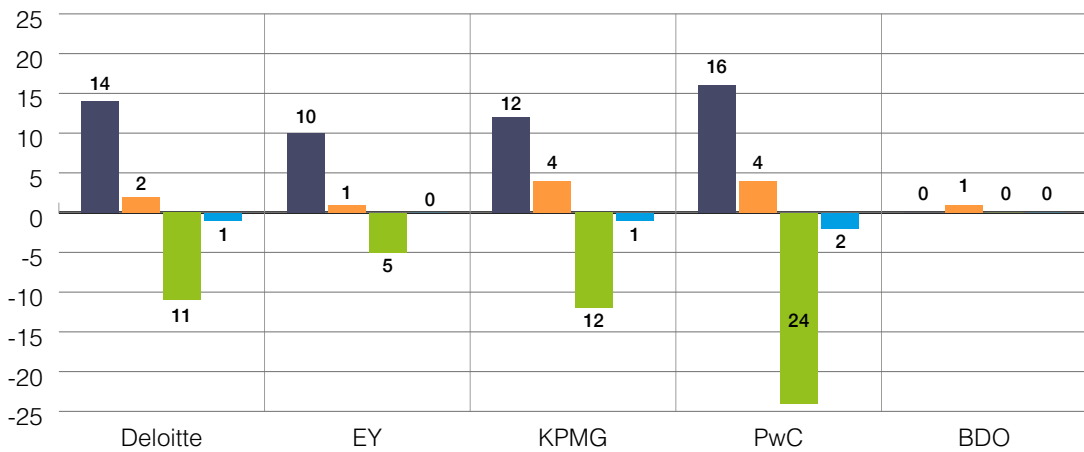
Graph 7: FTSE 350: audit firm market share¹⁴



■ Pre-tender
■ Post-tender

At the cut-off point for our data, EY have made a net gain of 5 audits and Deloitte 3 within the FTSE 100, PwC have a corresponding net loss of 8, and KPMG has neither gained nor lost in overall numbers.¹⁵

Graph 8: Tendering outcomes in the FTSE 100 2011-17¹⁶

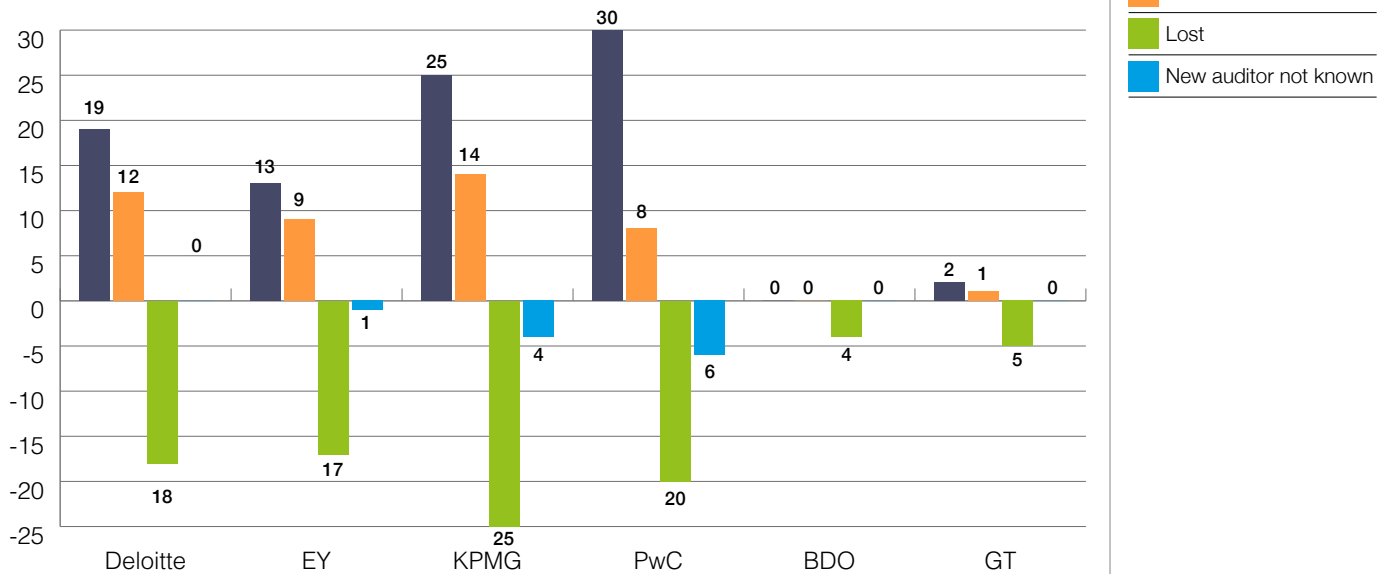


■ Won
■ Held
■ Lost
■ New auditor not known

By contrast, PwC have gained a net 10 audits in the FTSE 250, Deloitte 1, EY has lost 4 and BDO and Grant Thornton have lost 7 audits. So, overall there has been some re-distribution between the Big Four firms.

¹⁴ The data for this graph was drawn on information published by FTSE 350 companies, and compares market share between 2011 and 2017 taking account of audit tenders in that period.
¹⁵ Note that our estimate of net gains and losses excludes known tenders where the successor auditor has not yet been publicly disclosed.
¹⁶ Analysis based on our analysis of published data on tenders in the FTSE 350 2011-2017.

Graph 9: Tendering outcomes in the FTSE 250 2011-17¹⁷



Data on the effect of increased competition within FTSE market sectors is not conclusive, but suggests that there has been a slight increase in the representation of audit firms across the market. So, for example, before the tendering changes were implemented KPMG had 50% of bank audits within the FTSE 350, and 25% afterwards. Each of the other Big Four firms gained a banking client, including EY who were not previously represented in the sector. However, across all 36 main business categories any overall effect is less pronounced:

Table 2¹⁸

Business sectors: % by number of audit firms with clients in each sector	Pre tenders	Post tenders
% with 5 audit firms	3%	3%
% with 4 audit firms	17%	19%
% with 3 audit firms	22%	19%
% with 2 audit firms	31%	36%
% with 1 audit firms	28%	22%
% with > 1 audit firms	72%	78%

¹⁷ The data for this graph was drawn on information published by FTSE 350 companies, and compares market share between 2011 and 2017 taking account of audit tenders in that period.

¹⁸ Analysis based on our analysis of published data on tenders in the FTSE 350 2011-2017.



Some audit firms have told us that although tendering has driven innovation, efficiency and competition on the grounds of quality, the potential related downward pressure on audit fees might represent a risk to quality in the longer term.

Tendering & Fees

We have already noted that audit fees are relatively less significant than non-audit revenues to the major professional networks. Some audit firms have told us that although tendering has driven innovation, efficiency and competition on the grounds of quality, the potential related downward pressure on audit fees might represent a risk to quality in the longer term. Based on the published data for the FTSE 350, the evidence is that audit fees continue to increase overall at this end of the market.¹⁹

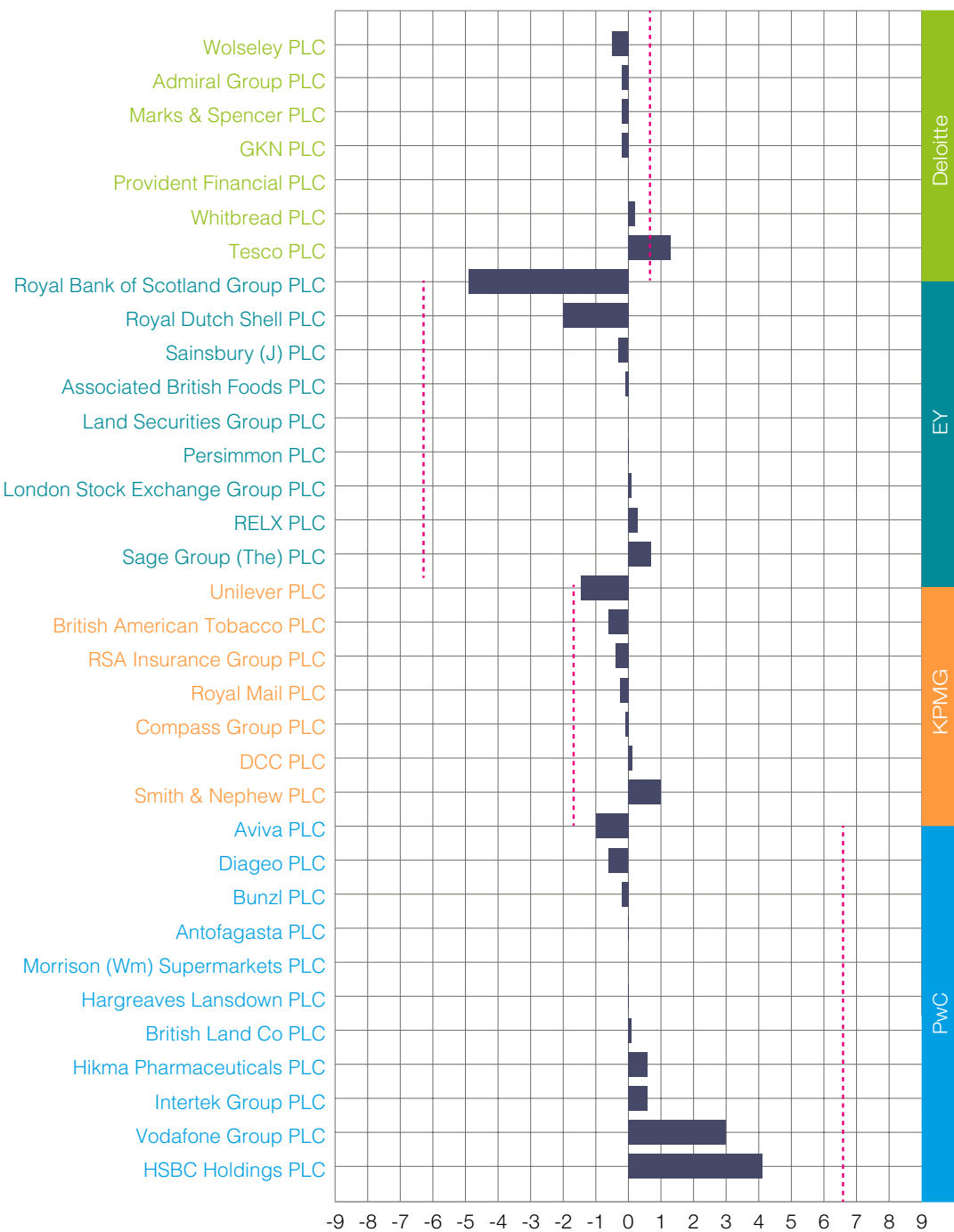
FTSE 250	
In % 2015 to 2016	
Audit Fee moved	+1.37%
Total Fee moved	+5.38%
FTSE 100	
In % 2015 to 2016	
Audit Fee moved	+4.21%
Total Fee moved	+3.31%

It is difficult to generalise about the relationship between movements in audit fees for audit engagements, and the impact of individual factors. Fees for any audit can fluctuate depending on a large number of individual factors, including for example those related to the complexity of business operations, nature of the risk assessment in any particular period and group structures. Some general observations are however possible, based on published data which indicates that:

- In aggregate, when an audit tender has taken place and a new auditor has been appointed, audit fees went down. This is not consistent for every audit in this category
- nor is it necessarily consistent depending on the firm which won the tender;

¹⁹ This is supported by feedback from some of our other stakeholders who have reported anecdotal evidence that bidding firms have sometimes increased fees on the basis of audit quality and new regulations.

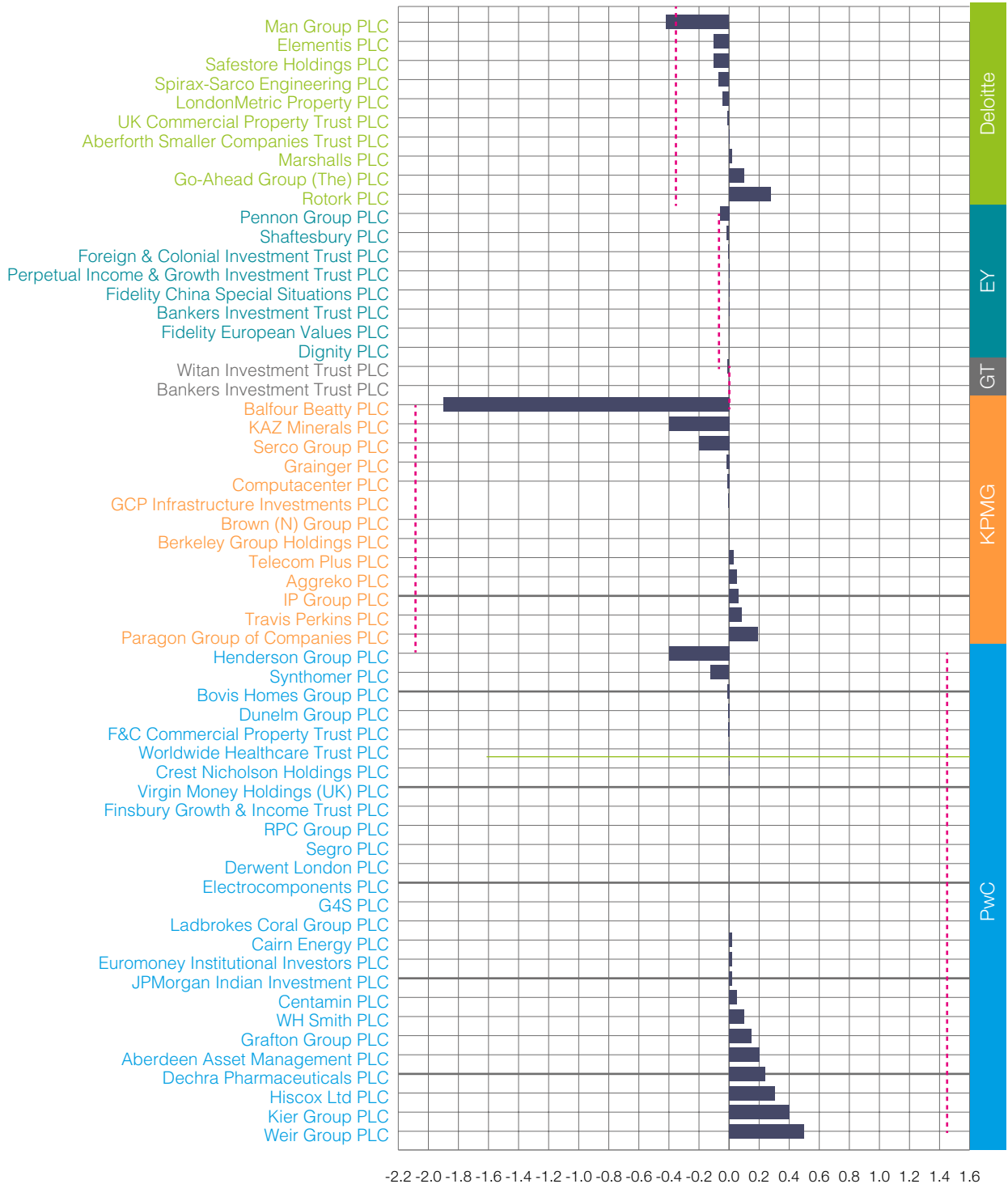
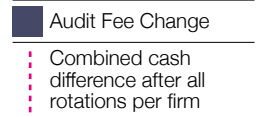
Graph 10: FTSE 100 - Audit fee change where an audit tender has taken place and a new auditor appointed²⁰



■ Change in Audit Fee
 ··· Combined cash difference after all rotations per firm

²⁰ Analysis based on our analysis of published data on tenders in the FTSE 350 2011-2017.

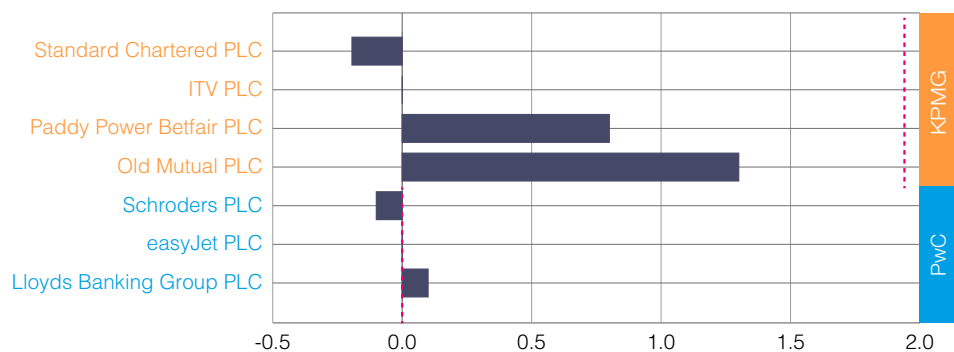
Graph 11: FTSE 250 - Audit fee change where an audit tender has taken place and a new auditor appointed²¹



– By contrast, and again in aggregate, when a tender has taken place and the incumbent auditor has been reappointed then fees tended to increase (but again not in every case).

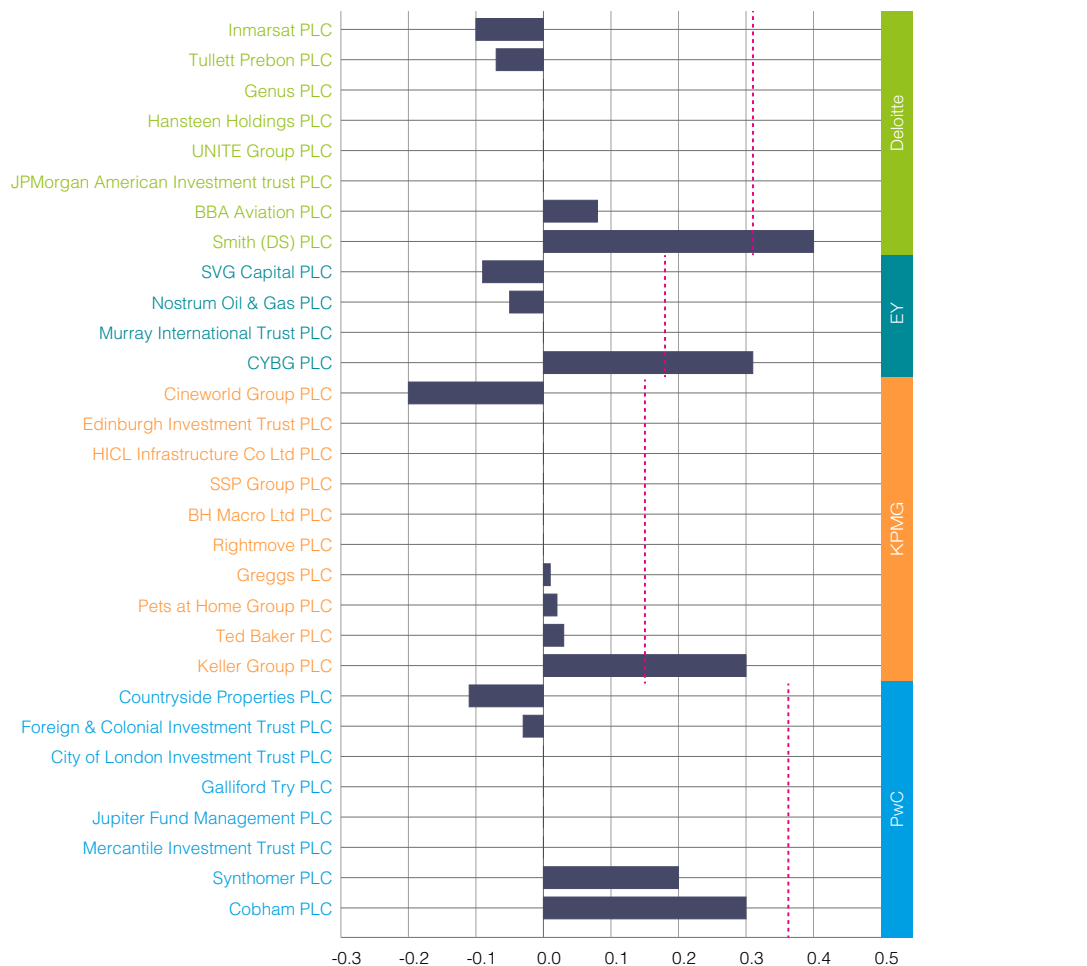
²¹ Analysis based on our analysis of published data on tenders in the FTSE 350 2011-2017.

Graph 12: FTSE 100 - Audit fee change where an audit tender has taken place and the incumbent reappointed²²



Audit Fee Change
 Combined cash difference after all rotations per firm

Graph 13: FTSE 250 - Audit fee change where an audit tender has taken place and the incumbent reappointed²³



Audit Fee Change
 Combined cash difference after all rotations per firm

²² Analysis based on our analysis of published data on tenders in the FTSE 350 2011-2017.

²³ Analysis based on our analysis of published data on tenders in the FTSE 350 2011-2017.

By comparison, the data for a sample of companies who have not had a tender shows that in the period 2014-16 more companies have seen audit fees increase

compared to those experiencing a decrease, although in two of those years there was a net reduction overall.

Table 3: audit fee outcomes for a sample of FTSE firms where no audit tender took place

FTSE 100	Number with audit fee decrease	Number with no change in audit fee	Number with audit fee increase	Average fee change
2014 Control Group	6 (30%)	5 (25%)	9 (45%)	1.0%
2015 Control Group	17 (30%)	11 (20%)	28 (50%)	-4.0%
2016 Control Group	20 (28%)	13 (18%)	38 (54%)	3.7%

FTSE 250	Number with audit fee decrease	Number with no change in audit fee	Number with audit fee increase	Average fee change
2014 Control Group	10 (20%)	13 (26%)	27 (54%)	-4.1%
2015 Control Group	6 (16%)	8 (21%)	24 (63%)	-1.6%
2016 Control Group	36 (22%)	31 (20%)	96 (58%)	4.8%

Global Networks

The major audit firms that operate in the UK are part of global professional services networks. Any consideration of the current condition of the UK audit market must therefore take account of international developments.

The FRC's role as the competent authority limits our remit to the UK, and we do not regulate the global networks. In addition, there are many statutory limits on the information which can be exchanged between international audit regulators. Nevertheless, whenever failures arise in the global networks we take action to get evidence that the UK firms have responded in a timely and appropriate way. The audit firm governance code includes the need to ensure that UK public interest is safeguarded in international structures, and we also actively participate in bodies such as the International Forum of International Audit Regulators (IFIAR) and the CEAOB. We are therefore able to share knowledge and practical experience with other audit inspection regimes, and compare findings and processes to help identify best practices and areas of commonality.

Issues arising anywhere within these networks can potentially indicate more widespread problems in those firms and so the FRC stays alert to network developments. For example, PCAOB Board member Steven Harris reflected in May 2017 that:

...in the past five months, the PCAOB has announced several enforcement settlements with international affiliates of global network firms where firm personnel – including senior partners with leadership roles – issued materially false audit reports, altered audit work papers, pressured others within the firm to do the same, withheld documentation, provided false testimony, and did not cooperate with our inspections and subsequent investigations.

Leaders of audit firms must not tolerate such total disregard for established rules and standards. They must take steps to ensure that a robust and sound system of quality control exists in all their affiliates as well.²⁴

²⁴ <https://pcaobus.org/News/Speech/Pages/Harris-speech-CPAB-5-17-17.aspx>

FRC AND THE REGULATORY ENVIRONMENT

The role of the FRC

The Financial Reporting Council promotes high quality corporate governance and reporting to foster investment. We promote high standards of corporate governance through the UK Corporate Governance Code, and encourage engagement between investors and Boards through the Stewardship Code. We set standards for corporate reporting, audit and actuarial practice and monitor and enforce accounting and auditing standards. We also oversee the regulatory activities of the actuarial profession and the professional accountancy bodies and operate independent enforcement arrangements for public interest cases involving accountants and actuaries.

Our role is to help promote the principles, professional behaviour and culture which are collectively fundamental to quality audit outcomes, and which serve the public interest. We do this through timely and effective regulation of the market:

- Setting principle based standards for auditors to follow, and providing guidance on how to apply these principles in practice;
- Establishing qualification registration and ongoing obligations for auditors which are discharged through our delegation arrangements to the RSBs;
- Monitoring and reporting on the quality of audits being done for the largest UK companies (Public Interest Entities);



- Working with the Recognised Supervisory Bodies (RSBs) to examine the quality of audits across the full population of UK companies subject to audit;
- Taking effective enforcement action against those auditors who fail to meet the expected standards, and learning lessons from those failures;
- Providing thought leadership on emerging issues and risks in the market, internationally as well as domestically;
- Engaging with all stakeholders who have an interest in the delivery of high quality audit, including investors, auditors, companies, regulators, government and the wider public.

Our independence is crucial to our effectiveness as a regulator. Our policy is to be as transparent as possible in the way that we operate, to consult and to work with a full range of stakeholders to demonstrate how we operate in the public interest.

FRC's objectives for audit

The FRC has set a strategic objective of promoting justifiable confidence in audit. Our seven key aims for audit in the UK are that:

- Audit and auditors are trustworthy, act with integrity and professional scepticism, serve the public interest and consistently demonstrate that the objectives of audit and auditing standards are met;
- Audit is subject to appropriate oversight within a clear regulatory regime;
- Roles and responsibilities of auditors and Audit Committees are clear, and aligned with the interests and needs of investors;
- Audit is a sustainable business with adequate capacity, and sufficient levels of investment, competition and choice;
- Audit innovates to meet changing business and economic circumstances to improve audit quality;
- Global audits are effectively managed and overseen, and quality is consistent across international work; and
- There is a mechanism for standard setting to be more responsive to the needs of users, and to respond to emerging issues on a more timely basis.

We aim to promote continuous improvement, taking tough action when necessary and focussing on areas of higher risk to the public interest.

For audit our aim is that by the end of the strategy period in 2019 at least 90% of FTSE 350 audits will require no more than limited improvements as assessed by our monitoring programme, which compares with 81% in 2016/17.

Competent Authority

Under the EU Audit Regulation and Directive the FRC has been designated Competent Authority for Audit. Importantly,

we have delegated significant aspects of tasks to the Recognised Supervisory Bodies for audit (RSBs), retaining those tasks in connection with Public Interest Entities (PIEs) and Third Country Auditors. PIEs include those entities with securities listed on a regulated UK market, unlisted banks and unlisted insurers. By agreement the FRC has retained those tasks also for larger entities listed on non-regulated markets and for Lloyd's syndicates.

We also have responsibility for the regular monitoring of public interest entity statutory market developments, assessment of risks arising from and the need to adopt counteractive measures against quality and systematic deficiencies within a firm which may lead to:

- a) the firm's demise;
- b) the disruption in the provision of statutory audit services in a sector or across sectors,
- c) the further accumulation of risk of audit deficiencies; and
- d) the impact on the overall stability of the financial sector.

Our market monitoring responsibilities also include market concentration levels, including in specific sectors, and the performance of Audit Committees.

2016/17

In 2016/17 our major task has been to establish and make the most effective use of the new role we have been given by Government as UK Competent Authority for audit regulation. This has included:

- Developing the new arrangements for how we work with the professional bodies, including oversight, delegation, sanction and enforcement arrangements. The professional oversight section of this reports sets out this aspect of our work in detail;
- Continuing our statutory oversight of the Recognised Supervisory Bodies, including discussions about the

continuing education and training of auditors, including the implementation of International Education Standard 8 (IES8) issued by the International Accounting Standards Education Board and effective from 1 July 2016. The professional oversight section of this report sets out this aspect of our work in detail;

- Monitoring and reporting on the quality of around 140 individual PIE audit engagements. We continue to implement the Competition and Markets Authority (CMA) recommendation that all FTSE 350 audits should be inspected on average once every five years. The monitoring of audit quality of this reports sets out this aspect of our work in detail;
- We have extended our thematic reviews which allow us to drill deeper into specific audit risk areas. In 2016/17 we have undertaken thematic reviews of firms' quality review processes, the use of data analytics and firms' root cause analysis of the findings from internal and external monitoring. The monitoring of audit quality of this reports sets out this aspect of our work in detail;
- Undertaking monitoring of smaller audit firms auditing Public Interest Entities (PIEs) to meet the requirements of the ARD. The monitoring of audit quality of this reports sets out this aspect of our work in detail;
- Supporting the important role of audit firm and network firm culture in promoting audit quality - including by issuing a revised Audit Firm Governance Code. The section on standard setting, codes and guidance of this reports sets out this aspect of our work in detail

In addition, we continue to see through the impact in extended Audit Committee and auditor reporting.

Audit Quality and Indicators of Progress

We describe high quality audit as something which:

... provides investors and other stakeholders with a high level of assurance that the financial statements of an entity give a true and fair view, and provide a reliable and trustworthy basis for taking decisions. Auditors carrying out high quality audit act with integrity and objectivity, are demonstrably independent and do not act in a way that risks compromising stakeholders' perceptions of that independence.

High quality audit complies with both the spirit and the letter of regulation and is supported by rigorous due process and quality assurance. It clearly demonstrates how it reflects investor and other stakeholder expectations, is driven by a robust risk assessment informed by a thorough understanding of the entity and its environment, and provides challenge, transparency and insight in a clear and unambiguous way.

High quality audit provides a strong deterrent effect against actions that may not be in the public interest, underpins stakeholder confidence, and drives continuous improvement.

We use a range of indicators to assess the progress being made in enhancing audit quality. Some of these sources of evidence we collect every other year – for example the benchmark YouGov survey, 'Improving Confidence in the Value of Audit'.²⁵ Others, such as our surveys of the implementation of extended auditor reporting are timed to coincide with changes in the standards or new policy initiatives.²⁶ In this report we assess the overall trend in audit quality by taking account of this material and also through more recent evidence such as:

²⁵ <https://www.frc.org.uk/OurWork/Publications/Audit-and-Assurance-Team/Research-Report-Improving-Confidence-in-theValue.pdf>

²⁶ Our most recent report can be found at: <https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Report-on-the-Second-Year-Experience-of-Extended-A.pdf>



The findings from the FRC’s annual audit quality inspection activities. Progress towards our aim that by the end of the strategy period at least ninety percent of FTSE 350 audits will require no more than limited improvements as assessed by our monitoring programme.

Our key message is that the overall standard of audit work being done for FTSE 350 companies in the UK is improving. Audit opinions are reached independently and are generally well supported by audit work. There is evidence of continuous improvement, particularly for larger audits. However, a higher proportion of audits we reviewed outside the FTSE 350 main market required more than limited improvements. Across all audits, outcomes are inconsistent between the firms, with areas of identified good practice such as enhanced quality control procedures also often those areas where there is most room for improvement. As a result we report no overall change in audit quality across all the audits we reviewed in 2016/17.

YouGov carried out a survey of Audit Committee chairs of Public Interest Entities, asking for their views on the quality of external auditors for their entities.

As in previous years, the assessment of Audit Committee chairs is very positive- 39 per cent considered their auditor to be ‘excellent’ and a further 51 per cent considered their auditor to be ‘above average’. The remaining 10 per cent assessed their auditor as being ‘average’

27 REGULATION (EU) No 537/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC

28 See Key Facts and Trends in the Accountancy Profession 2017, [https://www.frc.org.uk/Our-Work/Publications/Professional-Oversight/Key-Facts-and-Trends-in-the-Accountancy-Profes-\(2\).pdf](https://www.frc.org.uk/Our-Work/Publications/Professional-Oversight/Key-Facts-and-Trends-in-the-Accountancy-Profes-(2).pdf)

2017/18 Priorities

Our priorities for 2017/18 are:²⁹

- Enhancing the speed and effectiveness of our enforcement role:

The FRC has changed its procedures to ensure that it undertakes reviews and prosecutions as speedily as possible and to ensure that it has sufficient resources to accomplish its responsibilities. We have initiated an independent review of the effectiveness of sanctions. [see the enforcement and case progress section of this report]:

- Promoting justifiable confidence in auditing:

Priority sectors for audit monitoring will be Property, Travel & Leisure, Financial Services, and Support Services:

Areas of focus will be changes in auditor appointment, audit of pension balances and disclosures, and impact of currency fluctuations. The planned number of reviews also includes an increased number of unlisted insurers following the broadening of the definition of PIEs to include insurance undertakings.

Thematic reviews will be conducted in the following areas:

- i) Audit firm culture and governance, following the recent report on Corporate Culture;
- ii) Auditors' responsibilities for areas of the annual report beyond the financial statements, including the audit of directors' remuneration, and auditors' reporting by exception on other matters such as risk management and viability statements; and
- iii) Materiality – to provide an update and explain developments in the last four years since our previous thematic review in this area.

We are also launching an Audit and Assurance Lab, building on the successful model of the Financial Reporting Lab, to provide a mechanism to work with Audit Committee members, listed companies, investors and audit firms to identify and promote ways to further enhance confidence in audit. The Audit and Assurance Lab's first project will consider how to enhance the role of Audit Committee Reports and how they interact with Auditor's Reports.

The FRC has changed its enforcement procedures to ensure that it undertakes reviews and prosecutions as speedily as possible.

²⁹ A fuller description of our 2017/18 priorities can be found in our 2017/18 plan and budget: <https://www.frc.org.uk/About-the-FRC/Reports-Plans-and-Budgets.aspx>

HOW WE ARE DELIVERING OUR STRATEGY

SETTING AUDITING STANDARDS, CODES AND GUIDANCE



High quality audit complies with both the spirit and the letter of regulation and is supported by rigorous due process and quality assurance... High quality audit provides a strong deterrent effect against actions that may not be in the public interest, underpins stakeholder confidence, and drives continuous improvement.

As Competent Authority for audit in the UK, the FRC is responsible for setting auditing standards and issuing guidance to help auditors with the application of those standards. The diagram below sets out the range and scope of our work in the audit policy team, and how we contribute towards the FRC's objective to promote justifiable confidence in audit. Our key focus, as with other colleagues in the FRC, is in ensuring continuous improvement in the quality of audit in the UK, and maintaining its relevance to the needs of users.

Who we are and what we do: AUDIT POLICY TEAM

What is the Audit Policy Team?

The team within the FRC that sets the professional standards, helps with interpretations of standards and issues guidance which primarily contributes towards the overall quality of audit work being performed in the UK.

These include the Ethical Standard for Auditors; International Standards on Auditing (UK) which apply to the audits of financial statements; engagement standards covering specific areas, such as the Client Assets Standard; and Standards on Investment Reporting (SIRs).

Set standards for audits in the UK

Issue guidance on how to apply standards

Our guidance is persuasive rather than prescriptive and indicative of good practice. Auditors should demonstrate awareness of this guidance, or explain how they have otherwise complied with engagement standards. We help auditors apply standards to specific circumstances or sectors, such as insurance, charities and financial instruments.

We are strongly committed to engaging with all of our stakeholders when issuing or revising new standards or guidance. This ensures that we develop material in time to address issues in the market, which is proportionate to the risk, relevant to the circumstances, and in the public interest.

Stakeholder Outreach

Transparent Consultation

We consult publicly before issuing new material, and are committed to a transparent process. We publish all consultation responses and explain how we have responded to feedback.

We are represented on the Board of the IAASB and actively participate in key task forces. We respond to international standards consultations by bodies such as the IAASB, IESBA, PIOB and IAESB. We engage with institutions and other regulatory bodies internationally to identify emerging trends, and to promote and educate about our approach to audit policy issues in the UK.

International influencing

A 'joined' up regulator

We work closely with our colleagues in the audit monitoring and enforcement teams to identify areas where our standards or guidance need to be strengthened or improved.

We work closely with UK policy makers and regulators including BEIS, the PRA and the FCA to ensure that audit policy and standards are consistent and congruent with relevant legislation and regulation. We also work to ensure that lessons are learned and applied.

Work with UK policy makers and regulators

This section of the report provides an overview of the key developments in audit policy since our last annual Developments in Audit Report in 2016. In summary these are:

- Implementing the new and revised Ethical and auditing standards, including those changes which were the result of new EU requirements under the EU Audit Regulation and Directive
- Influencing and contributing towards the development of International Auditing Standards
- Updating our guidance for auditors in the UK

Implementation of new and revised standards

In our last report we set out the background to changes in auditing standards and regulation as a result of new EU requirements which came into effect in June 2016, including a new Ethical Standard for auditors and revisions to many of the auditing standards. We have now moved into the implementation phase for those changes. This has presented many challenges to the profession and to companies, Audit Committees and other Auditors, particularly around issues of interpretation. There are some areas where the specific intent of some the EU legislation is not clear and some requirements are being interpreted in different ways in different EU member states.

The FRC engages with Audit Committee chairs, investors, professional bodies and auditors in addressing significant matters of judgement, guiding Auditors rather than intervening in their decision making process. The new ethical standard is built on the principle of viewing independence through the eyes of an objective, reasonable and informed third party. Auditors are establishing ways of seeking such a perspective, engaging with INEs and key investors. Investors have raised concerns with the FRC that not all firms are demonstrably serving the interests of investors.

In order to help the implementation process, we established a Technical Advisory Group (TAG) which brings together representatives from audit firms, Audit Committee members, investors and the professional bodies to help develop a common understanding of the implications of these new requirements. This group has met eight times so far in 2016 and 2017 with much of the discussion focused on the challenges presented by the changes and additions to the UK Ethical Standard, particularly with regard to firms maintaining independence and avoiding conflicts of interest in carrying out their audit work.

The FRC has developed guidance either made available through a rolling record of issues discussed at the meetings,³⁰ or through the development of Staff Guidance Notes (SGNs) covering topics such as Prohibited Tax Services, Power of Attorney, Period of Engagement, Playing any part in management or decision making, Provision of non-audit services to non- EU subsidiaries and Services Linked to Financing.³¹ Following an approach from the Company Reporting and Auditing Group (CRAG), the FRC has developed further guidance on the application of the objective, reasonable and informed third party test, and made it available on the FRC website.³² We hope that this transparent and inclusive approach to matters of interpretation will help drive consistency in the application of the principles in the Ethical Standard, and help allay the fears of investors about how firms are serving their interests.

The Committee of European Audit Oversight Bodies (CEAOB), a European organisation of which the FRC is a member, has been established with the objective of facilitating the exchange of information, expertise and best practices for the implementation of the Audit Regulation and Directive. The CEAOB is also currently in the process of setting up a mechanism to assess and respond to requests on interpretation of the new requirements, and the FRC has agreed to participate in this mechanism, given the size of the UK capital market, and the fact that many issues of interpretation have tended to be

³⁰ A record of the group discussion is made publicly available on the FRC's website. <https://www.frc.org.uk/Our-Work/Audit/Audit-and-assurance/Standards-and-guidance/Standards-and-guidance-for-auditors/Staff-Guidance-Notes.aspx>

³¹ The Staff Guidance Notes can be found on our website at <https://www.frc.org.uk/Our-Work/Audit-and-Actuarial-Regulation/Audit-and-assurance/Standards-and-guidance/Standards-and-guidance-for-auditors/Staff-Guidance-Notes.aspx>

³² See the rolling record of actions of the Technical Advisory Group at <https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/FRC-Technical-Advisory-Group-Rolling-record-of-ac.pdf>

raised by UK Auditors earlier than in other EU member states. This work remains at an early stage of development.

Audit Firm Governance Code

Auditors carrying out high quality audit act with integrity and objectivity, are demonstrably independent and do not act in a way that risks compromising stakeholders' perceptions of that independence.

In July 2016 we issued a revised Audit Firm Governance Code, effective for financial years beginning on or after 1 September 2016. The Code applies to firms that audit 20 or more listed companies, but may also be adopted on a voluntary basis by firms auditing fewer than that.

The revised Code followed a review of the implementation and operation of the original Code, which was first issued in 2010.

From the outset key objectives of the Code have been to promote audit quality and ensure that risks to the firms are managed in the public interest. It provides a benchmark of good governance practice against which firms can report. Amongst other things the Code included provisions for the appointment of independent non-executives (INEs) within the governance structure of the firms, and for dialogue between the firms and investors in listed companies.

Our review of the Code had indicated that it was generally working well, but that there was scope for increasing the focus on audit quality, improving transparency and greater clarity about the role of INEs within the firms. The revised Code has therefore been amended to:

- Sharpen the Code's purpose to ensure that audit quality is at its core;
- Introduce a minimum number of INEs for firms and a provision that at least one should have experience in audit or another relevant sector; and
- Maximise transparency in reporting by the firms and their independent non-executives.

In identifying and implementing these changes we have sought to apply relevant learning from enhancements made to the UK Corporate Governance Code. For example, audit firms are required to produce transparency reports where they report on their performance against KPIs relevant to the Code. We are now asking the firms to make sure that their reports are fair, balanced and understandable as required of listed companies by the Corporate Governance Code. We have introduced a provision on the disclosure of INE remuneration, and the Code now requires reports from the INEs and public interest committees. This should improve their relevance and usefulness to investors and other stakeholders.

We will continue to monitor the implementation and operation of the revised Code including through regular liaison with the firms and their independent non-executives.

International influence and thought leadership

Public Interest Oversight Body (PIOB)

The Public Interest Oversight Board (PIOB) is appointed by the Monitoring Group³³ to ensure that international standards properly represent the public interest. The FRC maintains an active dialogue with the PIOB, and in late 2016 responded to the consultation on the future strategy of the PIOB. The FRC responses were intended to further strengthen the way in which the public interest is represented.

International Auditing and Assurance Standards Board (IAASB)

As the UK's auditing standards setter we work closely with the IAASB to ensure that our professional standards reflect the latest developments internationally. Our Executive Director of Audit Policy is an independent public interest IAASB Board member, and we participate in a range of key IAASB task forces. This allows us to share our experiences, help drive innovation and enhance the UK's interests and influence at a global level. The IAASB is currently prioritising work on those standards which

Audit firms are required to produce transparency reports. We are now asking the firms to make sure that their reports are fair, balanced and understandable as required of listed companies by the Corporate Governance Code.

³³ The Monitoring Group is a group of international financial institutions and regulatory bodies committed to advancing the public interest in areas related to international audit standard setting and audit quality.

are fundamental to the audit and the audit process, in the context of the many new challenges the profession is facing. This includes revisions to two of the auditing standards relevant to quality control (ISQC1 and ISA 220), the auditing standard which includes requirements addressing the identification and assessment of risks of material error in the financial statements (ISA 315),³⁴ and the auditing standards that deal with the audit of accounting estimates (ISA 540)³⁵ and group audits (ISA 600).³⁶ Underlying this work is a project to strengthen the application of professional scepticism.

Professional Scepticism

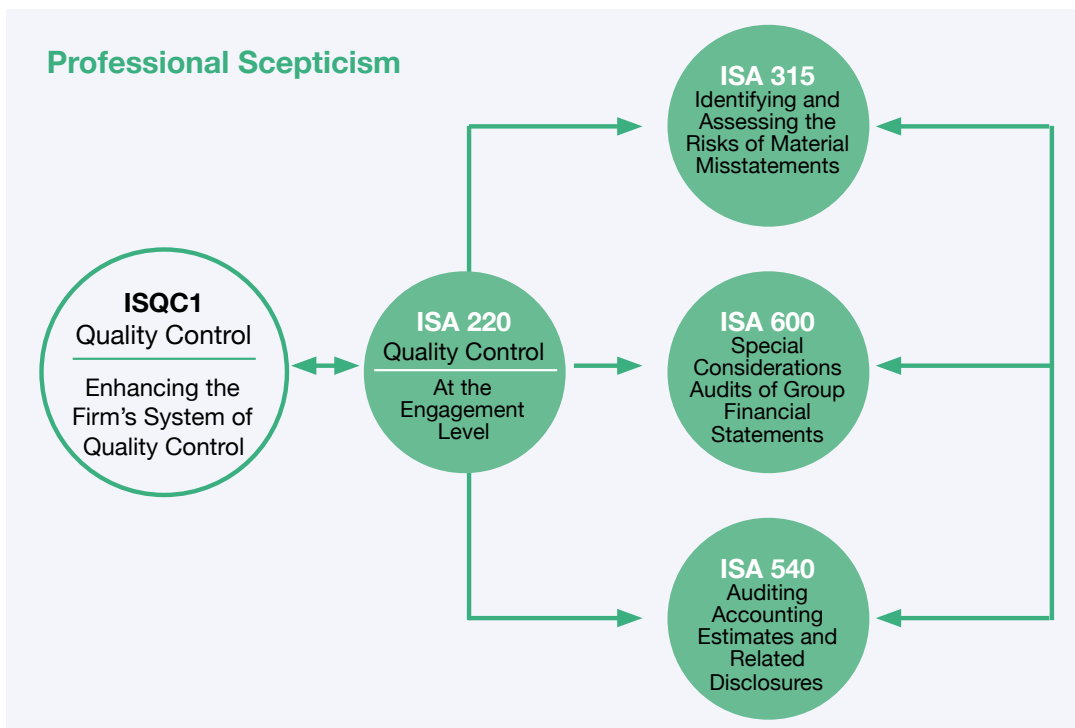
Stakeholders have called for improvements to be made to the international standards highlighted above for a number of reasons. In particular:

- Inspection findings by audit regulatory bodies and audit oversight bodies have consistently highlighted issues with respect to with respect to firms' quality control, auditor's risk assessments, including understanding internal control and consideration of information technology, and audits of group financial statements. Accounting estimates, in particular, continue to be the most common area where

weaknesses are found. These include a failure by auditors to challenge assumptions made by management with a sufficient level of professional scepticism, and insufficient attention to disclosures.

- Auditors of small and medium sized entities (SMEs) have noted specific challenges from a scalability perspective in effectively and efficiently applying the standards, particularly with respect to the quality control standards, the extent of understanding of internal control that is necessary in an audit of an SME under ISA 315 and the work effort required by ISA 540 for less complex estimates.
- The IAASB have been challenged as to whether the standards reflect evolving environmental influences. For example, since ISA 540 was last revised, developments in financial reporting³⁷ have led to increasing numbers of complex accounting estimates being reported in financial statements, Since ISA 315 was last revised, more advanced technology is being utilised, creating greater challenges for the auditor in understanding internal controls.

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34 ISA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding of the Entity and Its Environment
 35 ISA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
 36 ISA 600 Special Considerations – Audits of Group Financial Statements (including the work of component auditors)
 37 Such as IFRS 9 (Financial Instruments)³⁵ which introduces a new expected credit loss model for measuring financial instruments, IFRS 15 (Revenue Recognition from Contracts With Customers)³⁵, IFRS 16 (Leases)³⁵ as well as a prospective new standard dealing with Insurance Contracts.

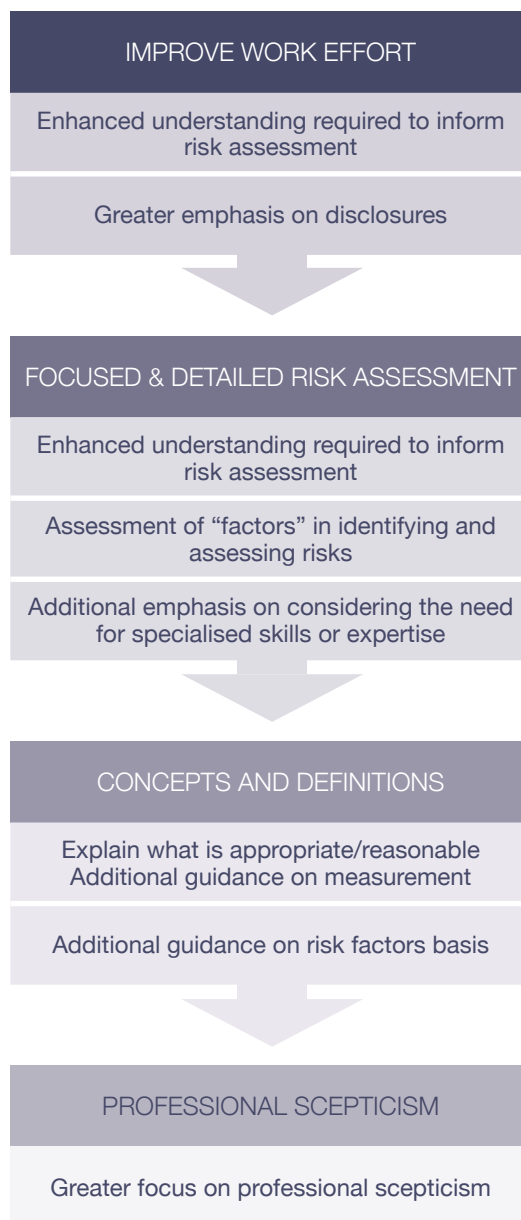
ISA 540

At the time this report was written the IAASB was consulting on changes to ISA 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.³⁸ The FRC is seeking UK stakeholder views of the exposure draft.

The proposed standard applies to all accounting estimates and is designed to be 'scalable' regardless of the size of the business or audit firm, or the sector in which the business operates. For example, when the auditor determines there is a low risk of material error in the financial statements, the proposed standard requires the auditor to determine whether one or more specific procedures may provide sufficient evidence. This is in contrast to circumstances where the risk of material error is not low. In this situation, the auditor's work effort is 'scaled up' and there are more detailed requirements for the auditor, including a greater focus on addressing the drivers to those risks.

A more focused and detailed risk assessment will drive improved audit testing and enhance audit quality. The auditor will have to think more carefully about the factors (the drivers to the risk) which could lead to material errors in the financial statements, such as the level of complexity in methods used to develop estimates, along with the degree of judgement made by management, as well as other factors including estimation uncertainty.

There is a greater focus on professional scepticism through the revised structure and workflow in the proposed standard. In addition, there is greater emphasis on the work effort in relation to disclosures which are critical to users' understanding of the accounting policies applied by the business.



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³⁸ The IAASB will publish the exposure draft towards the end of April with an August 2017 consultation deadline. Responses to the exposure draft are scheduled to be discussed at the board meeting in September 2017

ISA 315

The IAASB has established a task force to consider potential revisions to ISA to address the need for ISA 315³⁹ to:

- Reflect the evolving environmental influences (such as more advanced technology being utilised, changing internal control frameworks, increased complexity in business activities and resulting evolution in financial reporting requirements).
- Facilitate improvements in the application of the standard, particularly in relation to the auditors understanding of the entity and its internal controls.
- Set an enhanced risk assessment foundation, including for other standards (such as ISA 540 and ISA 600) and sharpen the auditors focus on the risk assessment in order to drive the most appropriate audit work.
- Emphasise the importance of the appropriate application of professional scepticism.

Quality Control (ISQC1, ISA 220) and ISA 600

The theme of audit quality pervades this report, and particularly how this can be driven forward on a more consistent basis. Our AQR thematic, for example, found many examples of good practice but also aspects of quality arrangements in UK firms which could be enhanced.

This has also been a key issue for the IAASB, which consulted in 2016 to properly understand the issues and inform related standard setting proposals. They concluded that a combined project proposal should be developed because of the numerous Auditorover issues and intrinsic links, particularly in relation to the interaction between the management of quality at the firm level and at the engagement level, both for single entity audit and group audit engagements.

The IAASB propose revisions to:

- Strengthen and improve the firm’s management of quality through:
- Improvements in governance and leadership within the firm, and an enhanced focused on an internal culture that supports quality.
- Revision of the extant approach to a ‘system of quality control’ through the introduction of a Quality Management Approach, both at the firm level and at the level of the engagement. The QMA is a more pro-active approach to managing quality through the identification, assessment and response to quality risks in a broad range of circumstances.
- Improvements in monitoring and remediation activities, including a greater focus on causal analysis.
- Enhancements to the firm’s activities when using the work of the network or a network firm.
- A reflection of the evolving environmental influences (such as more advanced technology being utilised by audit firms, and evolution in audit delivery models).
- Strengthen the auditor’s approach to planning and performing an audit, including a group audit, through
 - Enhancements to the standard in relation to engagement leadership, including greater specificity in the standard regarding engagement partners responsibility (e.g. for direction, supervision, and review on each audit engagement)
 - Enhancements to the interactions between ISQC1 and ISA 220, particularly in relation to the management of quality at the engagement level.
 - Enhancements to the connections between ISA 600 and the quality control standards, and other standards such as ISA 315 and ISA 330.

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³⁹ ISA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding of the Entity and Its Environment

International outreach and education

In addition to our direct participation in the IAASB we also engage with colleagues from different global capital markets, sharing experiences and insights on emerging risks and good practice.

One area of particular international interest continues to be the impact of Extended Auditor Reporting. The UK has now had three financial reporting cycles incorporating this enhanced form of reporting, with many other capital markets now anticipating their first after changes to International Auditing Standards. We have been able to share our experience in the UK, and particularly the feedback that we have received from investors that they welcomed our simultaneous reforms to auditor reporting; Audit Committee reporting; and the requirement for Directors to acknowledge their responsibility to prepare annual reports and accounts which are 'fair, balanced and understandable'. Our approach to extended auditor reporting was not prescriptive, and the market responded with innovative forms of reporting which were broadly welcomed by investors for providing greater transparency about the audit process. As the pace of innovation inevitably slows, the FRC will complete a post implementation review of our reforms, including how subsequent changes in International Standards impact on companies outside the main market in the UK.

We also responded to an important international consultation by the International Ethics Standards Board for Accountants (IESBA) about revisions to their Code of Ethics for Professional Accountants.⁴⁰ Having recently revised our own Ethical Standard (2016) we expressed concern at the current IESBA proposals, because we do not believe they go far enough to emphasise the centrality of the fundamental principles (Integrity, Objectivity, Professional Competence and Due Care, Confidentiality, Professional Behavior), or their relationship with detailed 'rules' or 'requirements'. We believe that ethical standards should be primarily driven by fundamental principles rather than a purely rules based approach. Principles can be applied to a wider range of circumstances

than could ever be captured by a set of specific rules, and are therefore more likely to achieve the right outcome of ethical behavior by auditors. We believe that the risk is that the current IESBA proposals could lead to a rules-based compliance mindset by professional accountants, rather than a focus on ethical behavior.

Guidance: Practice Notes for auditors

High quality audit complies with both the spirit and the letter of regulation and... is driven by a robust risk assessment informed by a thorough understanding of the entity and its environment, and provides challenge, transparency and insight in a clear and unambiguous way.

We publish a significant amount of guidance material for auditors which is designed to help them apply International Standards on Auditing (UK) to specific types of business sector or financial transactions. We have a commitment to revise this material on at least a five yearly basis to ensure it remains relevant and up to date.

Practice Notes are not mandatory, but are indicative of best practice and contribute towards our overall aim to support the delivery of high quality audit. Auditors are expected to demonstrate their awareness of our guidance, and to be prepared to explain how they have otherwise complied with the engagement standards where they have not followed it. This includes helping auditors where there are particularly complex regulatory requirements (banking and insurance for example); context and operations specific to a business sector (charities and public sector); or, particularly challenging types of transactions (financial instruments, pension schemes). Auditors who use ISAs (UK) are expected to be aware of our material, and to be prepared to explain where they have disregarded it how they have complied with the standards to deliver the same level of audit quality.

Our aim is to help drive up standards across the whole spectrum of audit and

Our approach to extended auditor reporting was not prescriptive, and the market responded with innovative forms of reporting which were broadly welcomed by investors for providing greater transparency about the audit process. As the pace of innovation inevitably slows, the FRC will complete a post implementation review of our reforms.

⁴⁰ IESBA is an independent standard setting body which sets international ethics standards for professional accountants, including auditor independence requirements. In the UK, FRC's Ethical Standard (2016) also applies for audits of financial statements, reports in connection with investment circulars, engagements to provide assurance on client assets and reviews of interim financial information. The Ethical Standard was developed with the intent that it should adhere to the principles of the IESBA Code. Our full consultation response can be found at: <https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/FRC-response-to-the-IESBA-consultation-on-Improvin.pdf>

assurance work, and to provide support which is helpful to auditors working in complex areas.

We develop this material in cooperation with audit practitioners, fellow regulators, sector experts and investors to ensure that we disseminate the best quality guidance possible. We put everything out for public consultation before finalizing it, and actively encourage comments from relevant individuals and bodies. We always explain how we have responded to those comments and any concerns raised.

Key areas where we have recently been developing new or revised guidance include:

Insurance and Solvency II

In 2016, most insurance undertakings in the UK were designated as public interest entities under the Audit Regulation and Directive. This means that a significant number of additional insurance company audits, and therefore audit firms, became subject to direct oversight and regulation by the FRC. At the same time, from 1 January 2016, a new prudential regulation regime – Solvency II – came into force across the EU. Solvency II made significant changes to the amount of capital insurance companies are required to hold in order to conduct business; to risk management and governance processes; and introduced new reporting requirements. Many insurance companies now have to publish annually an additional set of financial statements and disclosures called the Solvency and Financial Condition Report (SFCR). The Prudential Regulation Authority (PRA) has made an external audit of these reports mandatory in the UK.

As a result of these developments, we revised our guidance for insurance auditors: Practice Note 20: *The Audit of Insurers in the UK* (PN20). This brought the general guidance up to date in terms of regulation and standards, but also added important new material to help apply those standards to the audits of SFCRs. We did this in collaboration with audit practitioners, the PRA and representatives of the insurance industry. This helped to ensure

that our material was fit for purpose and proportionate to the need, and designed to be helpful for the widest possible community of auditors. Given the significant commitment of time and resources the UK insurance industry has invested in Solvency II, and the level of investor interest in the related public reporting, PN20 provides a strong basis for auditors to enhance confidence in this important new financial information.

Public Sector

We also worked with the Public Audit Forum to ensure that guidance for auditors working in the public sector was updated, particularly considering changes to the way local audit is carried out.⁴¹

Charities

We are currently consulting on changes to our guidance for auditors of charities (Practice Note 11: *The Audit of Charities in the United Kingdom* (PN 11)). Our guidance has been updated to reflect changes to the legislative and regulatory framework and developments in the accounting and audit framework, including a new Charities SORP.

There has been a significant amount of public, press and parliamentary attention on the charitable sector over recent years. For example, media reports have made serious allegations about some charities and their risky operating models, the use of exploitative and unethical fundraising methods, and the inappropriateness of certain partnerships with commercial entities. This has contributed to a fall in the overall level of public trust and confidence in charities.⁴²

In particular, the media attention and subsequent parliamentary investigation into Kids' Company in 2015 identified serious issues about the way the charity was governed and financially managed.

Our aim is to help drive up standards across the whole spectrum of audit and assurance work, and to provide support which is helpful to auditors working in complex areas whether they are from the "Big Four", mid-tier, smaller firms or the public sector.

⁴¹ The Public Audit Forum includes all of the national audit agencies, and took responsibility for the revision and publication of Practice Note 10, Audit of financial statements of public sector bodies in the United Kingdom. <http://www.public-audit-forum.org.uk/publications/>

⁴² Charity Commission in England & Wales Public trust and confidence in charities: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/532104/Public_trust_and_confidence_in_charities_2016.pdf

A parliamentary inquiry identified some key messages for professional services firms, including auditors. These related specifically to how robust auditor's assessments are of the use of the going concern basis of accounting by the management of a charity, and critically how effectively they communicate their conclusions to the trustees and, where appropriate, the charity regulator.

[the external auditor] has offered no credible explanation for changing the warnings of insolvency from those issued by the preceding auditors... It is surprising that [the external auditor] did not consider its duty to alert the Charity Commission to the extremely high risk of failure in this charity, in accordance with its duty as charity auditors under Section 156 of the Charities Act 2011. We note that this is a lesson that [the external auditor] appeared to accept under our examination, but this lesson should be learned by the audit profession as a whole.⁴³

More recently, a report on the funding and governance of Broken Rainbow found that the charity had been spending much more than its income for a number of years before its closure and was operating 'hand to mouth' for at least a year before it closed, highlighting that there continues to be concern over the operating models of charities and the reserves maintained.⁴⁵

All of this serves to highlight why guidance for auditors of charities remains invaluable. Our revisions to the auditor guidance were therefore designed to simplify and shorten the material, in order to provide a stronger focus on these critical matters. The auditor's duty to report matters of material significance has been given greater prominence and greater clarity. Similarly, the guidance we provide on the application of ISA (UK) 570 Going Concern has been substantially rewritten, and includes a series of indicators of risk in this area drawn from the lessons learned from these recent real life scandals and collapses.

Pension Schemes

At the time of writing this report, we have also consulted on changes to our guidance for auditors of pension schemes (Practice Note 15: *The Audit of Occupational Pension Schemes* in the United Kingdom (PN 15)). In doing so, we are being responsive to relevant changes in UK auditing standards; changes to UK accounting standards and revisions to the pensions SORP; changes in regulations and guidance issues by The Pensions Regulator (TPR); and to the increasing number of master trusts operating in the pension sector. We have also used the revision to prompt enhanced auditor scepticism when making an assessment of going concern in respect of a scheme that is subject to audit.

⁴³ Public Administration and Constitutional Affairs Committee, *The collapse of Kids Company: lessons for charity trustees, professional firms, the Charity Commission, and Whitehall* (February 2016).

⁴⁴ See the April 2017 NAO report; <https://www.nao.org.uk/wp-content/uploads/2017/04/Report-on-the-Funding-and-governance-of-Broken-Rainbow.pdf>



Preliminary Announcements

We have also issued a discussion paper looking at the role of auditors in connection with preliminary announcements.

Preliminary announcements continue to be a major part of the corporate reporting landscape in the UK, despite having been voluntary for listed companies since 2007. We conducted a survey of a sample of companies from the main market and AIM which showed that over 90% of companies on the main market, and 70% of AIM still issue preliminaries. Nearly 90% of those who do issue preliminaries do so using audited information drawn from annual accounts.

The key aspects of our discussion paper are the extent to which investors who use and make decisions based on preliminary announcements understand the role of the auditor, whether that role should be enhanced and whether all preliminaries should be based on audited information.

WORKING WITH AUDIT COMMITTEES

High quality audit complies with both the spirit and the letter of regulation and is supported by rigorous due process and quality assurance. It clearly demonstrates how it reflects investor and other stakeholder expectations, is driven by a robust risk assessment informed by a thorough understanding of the entity and its environment, and provides challenge, transparency and insight in a clear and unambiguous way.

The Audit Regulation and Directive and the UK Corporate Governance Code have provisions relating to the role of the Audit Committee, including specifics relating to the oversight of external audit. These give Audit Committees a critical role in tendering for audit services; assessing the quality and effectiveness of external audit; and monitoring compliance with ethical requirements. The main provisions in respect of external audit are:

to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;

to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;



*to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.*⁴⁵

The FRC views the role of Audit Committees as fundamental to ensuring that investors and other stakeholders can have confidence in the quality and independence of the audit work being carried out. We have supported Audit Committees by providing them with additional guidance on the application of the Code,⁴⁶ on how to evaluate the quality of external audit,⁴⁷ and best practice for audit tendering.⁴⁸ The Code now also contains a specific requirement for Audit Committees to report on how they have assessed the effectiveness of the external audit process.⁴⁹ An increasing number of Audit Committees are taking this opportunity to provide more detail about how they assess audit quality, and how they interact with the FRC.

⁴⁵ Relevant provisions are at C.3. <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-April-2016.pdf>

⁴⁶ [https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Audit-Committees-\(2\).pdf](https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Audit-Committees-(2).pdf)

⁴⁷ Audit Quality: Practice aid for Audit Committees (May 2015), [https://frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Audit-Quality-Practice-Aid-for-Audit-Committee-\(1\).pdf](https://frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Audit-Quality-Practice-Aid-for-Audit-Committee-(1).pdf)

⁴⁸ Audit Tenders Notes on Best Practice (Feb 2017), <https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Tenders-notes-on-best-practice.pdf>

⁴⁹ [https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Audit-Committees-\(2\).pdf](https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Audit-Committees-(2).pdf)

Example: Mondi Group:

Interaction with regulators⁵⁰

UK Financial Reporting Council (FRC) Audit Quality Review

The FRC's Audit Quality Review team selected to review the audit of the 2015 Mondi plc financial statements as part of their 2015 annual inspection of audit firms. The focus of the review and their reporting is on identifying areas where improvements are required rather than highlighting areas performed to or above the expected level. The chairman of the Audit Committee received a full copy of the findings of the Audit Quality Review team and has discussed these with Deloitte. The Audit Committee confirms that there were no significant areas for improvement identified within the report. The Audit Committee is also satisfied that there is nothing within the report which might have a bearing on the audit appointment.

Audit Committee reports now typically set out the criteria used in their assessment of external audit quality. Our desk-top review of FTSE 100 company reports identified a broad range of factors being considered. The majority of firms use some form of questionnaire seeking feedback from senior management as well as other individuals within the business. One consequence of our recent enhanced engagement with Audit Committees is that FRC audit reviews and firm wide reports are increasingly referenced in these reports. There is a clear and welcome emphasis on criteria relating to the mind-set of the audit, including independence, and increasing references to perceptions of an ethical audit firm culture and existence of effective quality control processes. Very few Audit Committee reports in our survey made any reference at all to 'cost efficiency' as being a prominent factor in their assessment, and equally few talked about innovation as being an important criteria.

⁵⁰ Mondi Group Integrated report and financial statements 2016, <http://reports2016.mondigroup.com/downloads/integrated-report-and-financial-statements-2016.pdf>

Graph 14: Factors influencing Audit Committee assessment of external audit quality⁵¹



Better quality and more detailed reporting provides greater insight to users of financial statements about the ways in which Audit Committees are delivering on their responsibility to ensure the highest possible quality external audit is being achieved:

The Committee is responsible for evaluating the performance of the external auditor. To assist the Committee in fulfilling these responsibilities, an assessment of the external auditor was carried out with feedback collected from key stakeholders by way of a questionnaire. The content of the questionnaire was prepared in accordance with the FRC's guidance comprising four criteria: mind-set and culture; skills, character and knowledge; quality control; and judgement. There was no significant change in the overall perceived quality of the 2015 audit and feedback did not identify any areas of significant concern. Areas for improvement

identified were communicated to PwC who responded appropriately. Audit effectiveness is also assessed throughout the year using a number of measures including: reviewing the quality and scope of the proposed audit plan and progress against the plan; responsiveness to changes in our businesses; and monitoring the independence and transparency of the audit. The assessment of the auditor's effectiveness forms part of the Committee's annual consideration of whether the auditor should be recommended to the Board for reappointment.⁵²

⁵¹ We surveyed 93 of the most recent published Audit Committee reports for FTSE 100 companies.

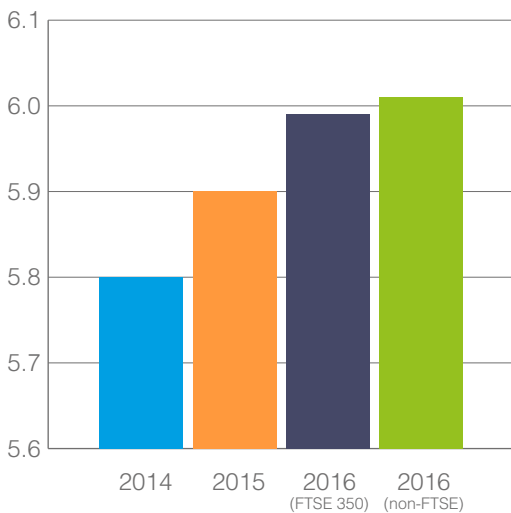
⁵² Schroders Annual Report and Accounts 2016.

FRC Audit Committee Chair survey

The FRC undertakes an annual survey of Audit Committee chairs to get their views on the quality of the audit they have received in the last audit cycle. This year, and to reflect the FRC's changed responsibilities for public interest entity audits (PIEs) as a result of the European Audit Regulation and Directive, the survey was sent out to PIE Audit Committee chairs rather than just FTSE 350 entities. We received responses from around 40 per cent of those surveyed.

Our survey asked Audit Committee Chairs to give their overall view on the quality of external audit. For the purposes of allowing comparison with prior years our scale is 1-7, with higher scores denoting greater confidence. In successive years we have seen results for the FTSE 350 increasing from 5.8 (2014), to 5.9 (2015) and now 5.99 (2016). The level of confidence was even higher amongst those non-FTSE 350 Chairs who responded to our survey, at 6.01.

Graph 15: Audit Committee Chair Survey: Overall rating of the quality of external audit



As in previous years, the assessment of Audit Committee chairs is very positive- 39 per cent considered their auditor to be 'excellent' and a further 51 per cent considered their auditor to be 'above average'. The remaining 10 per cent assessed their auditor as being 'average'. We asked Audit Committee chairs to give us their views about ways in which audit firms could improve further on what is already a very positive assessment. Suggestions included: using the auditor's insight to help Audit Committees understand the relative strengths and weaknesses of their entity; and using the auditor's knowledge to focus on what might happen in the future as well as what has already happened. Some Audit Committee chairs looked to their auditors to keep them abreast of changes in regulatory requirements, and some commented that their auditor could be more proactive in 'training' the Audit Committee on recent changes in the sector. Communication and engagement is very important to Audit Committee chairs – they clearly value the time they have to spend with the audit partner and their team. However, some Audit Committee chairs believed the quality of reporting to Audit Committees could be improved. Several commented that they received too many boilerplate documents, and others informed us that they just received too much documentation – auditors should really focus on what matters rather than give a long report on what they have done.

Although we did not focus specifically on audit tendering in this year's survey, a number of Audit Committee chairs included verbatim comments in which they commented on the importance of regular tendering as a way of comparing the offering from different audit firms, and as a way of setting clear expectations about how the auditor and the Audit Committee should communicate. Others commented that where they had seen a change of auditor as a result of rotation, they had been impressed by the time that had been invested by the new auditor to understand the business and to be able to develop a high quality plan which included a well thought out assessment of audit risk.

Communication and engagement is very important to Audit Committee chairs – they clearly value the time they have to engage with the audit partner and their team however, some Audit Committee chairs believed the quality of reporting to Audit Committee could be improved. Several commented that they received too many boilerplate documents, and others informed us that they just received too much documentation – auditors should really focus on what matters rather than a long report on what they have done.



Where we asked specific questions the satisfaction rate continues to be over eighty per cent – the strongest scores were for audit focus, approach and risk assessment and mind-set, culture and professional scepticism. Scoring less well (but still strongly) were the audit firm’s approach to quality management, and the communication between auditor and Audit Committee which showed the largest decline of any of the questions asked. Independence and objectivity continues to score highly – but Audit Committee chairs recognised the need for continued scrutiny as any perception that an auditor is not independent and objective will quickly undermine the value of audit to stakeholders.

The FRC has a public target to work with audit firms with a view to ensuring that by 2019 no more than 10 per cent of FTSE 350 audits require anything more than limited improvements. Several Audit Committee chairs commented on an increasing focus by auditors on FRC inspection findings, and some explained how their committee had responded to receiving a report from the AQR team, which included meetings senior staff in the audit firm to understand how the auditor proposed to respond, particularly where the findings had been critical. This year 71 per cent of respondents rated their auditor’s response to the regulator’s oversight as being of a high standard – this is a drop of 8 per cent over the prior year.

MONITORING OF AUDIT QUALITY AND 2016/17 FINDINGS

Headline findings

Our monitoring activity continues to show a modest upward trend in the quality of audit work in 2016/17, with 78% of UK and Crown Dependency audits assessed as either good or only requiring limited improvements. A key contributor to this was the quality of FTSE 350 audits we inspected, which improved for the fifth consecutive year, with 81% categorised as either good or requiring limited improvements, showing notable progress towards our strategy target that at least 90% of all FTSE 350 audits inspected are assessed as being in this category. This section provides an overview of our monitoring activities and results for 2016/17.

What is the scope of our audit monitoring activity?

Our AQR team monitors the quality of UK audit work of the financial statements of UK Public Interest Entities (PIEs) as well as certain other entities retained within the FRC's scope, such as Lloyd's Syndicates and large AIM-listed companies. Monitoring of all other statutory audits is delegated by the FRC to Recognised Supervisory Bodies under a series of Delegation Agreements.

Public Interest Entities are:

- Issuers whose transferable securities are admitted to trading on a regulated market;
- Certain credit institutions and insurance undertakings.

We also inspect audits of entities incorporated in Jersey, Guernsey or the Isle of Man whose securities are traded on a regulated market in the European Economic Area (although we do not do this in our capacity as UK Competent Authority, but rather by private, contractual arrangements with the relevant regulatory authorities in the Crown Dependencies). Finally, we have contractual arrangements in place to inspect the work of auditors of local public bodies and of the National Audit Office.

The following table provides an overview of the number of audits inspected across each inspection category for the past three inspection cycles.

Table 4: number of audit inspections

	2016/17	2015/16	2014/15
UK and Crown Dependency audit firms	116	113	105
Third Country Auditors	6	6	4
Local Public Audit ⁵³	11	12	11
National Audit Office ⁵⁴	6	6	6
Total audits inspected	139	137	126

⁵³ Under contract rather than on a statutory basis.

⁵⁴ Under contract rather than on a statutory basis.

UK and Crown Dependency audit firm inspections

In 2016/17 the inspection of UK audit firms included audits within the FRC's inspection scope (Major Audits) and those inspected on a contractual basis on behalf of the Crown Dependency Regulatory Authorities.

One further inspection on behalf of the Crown Dependency Regulatory Authorities was also undertaken in 2016/17.

The following tables provide, by firm and category of entity, an analysis of the 116 individual company audits inspected in 2016/17 (together with comparatives) at UK and Crown Dependency audit firms. The audits inspected include 16 Crown Dependency companies (2015/16: 13 companies).

Table 5: Analysis of inspections by types of audited entity

UK Audit Firms	2016/17	2015/16
Deloitte LLP	23	22
Ernst & Young LLP	17	20
KPMG LLP / KPMG Audit Plc	23	22
PriceWaterhouseCoopers LLP	27	25
Big Four firms	90	89
BDO LLP	8	8
Grant Thornton UK LLP	8	8
Big Six Firms	106	105
RSM UK Group LLP	3	1
Mazars LLP	0	1
Moore Stephens LLP	1	0
BSG Valentine LLP	1	0
Crown Dependency Audit Firms		
PriceWaterhouseCoopers CI LLP	5	0
KPMG Channel Islands Limited	0	6
Total audits inspected	116	113

Analysis	2016-17	2015-16
FTSE 100	24	17
FTSE 250	46	49
FTSE 350	70	66
Other listed	27	21
AIM	6	10
Non-listed insurer	5	0
Non-listed banks	4	4
Building society	2	1
Lloyd's Syndicates	1	0
Large private companies	1	6
Other	0	5
Total	116	113
Third country	6	6
Public Sector	17	18
Grand Total	139	137

The number of inspection continues to increase and following our designation as Competent Authority includes non-listed insurers and Lloyd's syndicates. Private companies (other than unlisted banks and insurers) are not PIEs and are therefore no longer within our inspection scope. We do, on occasion, continue to review some large private companies if they have listed debt or as part of joint inspections with other regulators.

What is our audit monitoring approach?

We monitor the quality of individual audits on a sample basis, selected to take account of both risk and to ensure coverage of the FTSE 350 over an average five year cycle. In selecting our sample, we also factor in priority sectors of the economy which we wish to focus upon.

In our 2016/17 inspection cycle the priority sectors were natural resources/extractive industries; companies servicing the extractive industries; business/support services including those supporting the public sector; and media.

For each inspection, we focus on certain areas of the audit, based upon the nature of the business as well as the key audit risk described in the audit report and the risks listed in the Audit Committee report. Areas involving higher level of judgement, such as impairment testing and asset valuations, typically feature more frequently in the selection. For each area, we consider the appropriateness of key audit judgments made in support of the audit opinion, and the sufficiency and appropriateness of the supporting audit evidence obtained.

An audit is assessed as good where we identified no areas for improvement of sufficient significance to include in our report. Category 2A indicates that we had only limited concerns to report. Category 2B indicates that more substantive improvements were needed in relation to one or more issues. An audit is assessed as requiring significant improvements (category 3) if we have significant concerns in relation to the sufficiency or quality of audit evidence, the appropriateness of key audit judgments or other matters identified. In such circumstances we may request some remedial action by the firm to address our concerns and to confirm that the audit opinion remains appropriate. We will generally review a subsequent year's audit to confirm that appropriate action has been taken.

Inspections are further supplemented by reviews of firm-wide procedures at individual firms, which include an assessment of how firm cultures impact on audit quality, and their internal quality assurance programmes. In addition, we undertake around three thematic inspections a year which entail an in-depth review of particular aspects of audit, such as the use of data analytics. Details of both firm-wide and thematic review results are presented later in this section.

Inspections are further supplemented by reviews of firm-wide procedures at individual firms, which include an assessment of how firm cultures impact on audit quality, and their internal quality assurance programmes. In addition, we undertake around three thematic inspections a year which entail an in-depth review of particular aspects of audit, such as the use of data analytics.

Results of our monitoring activity

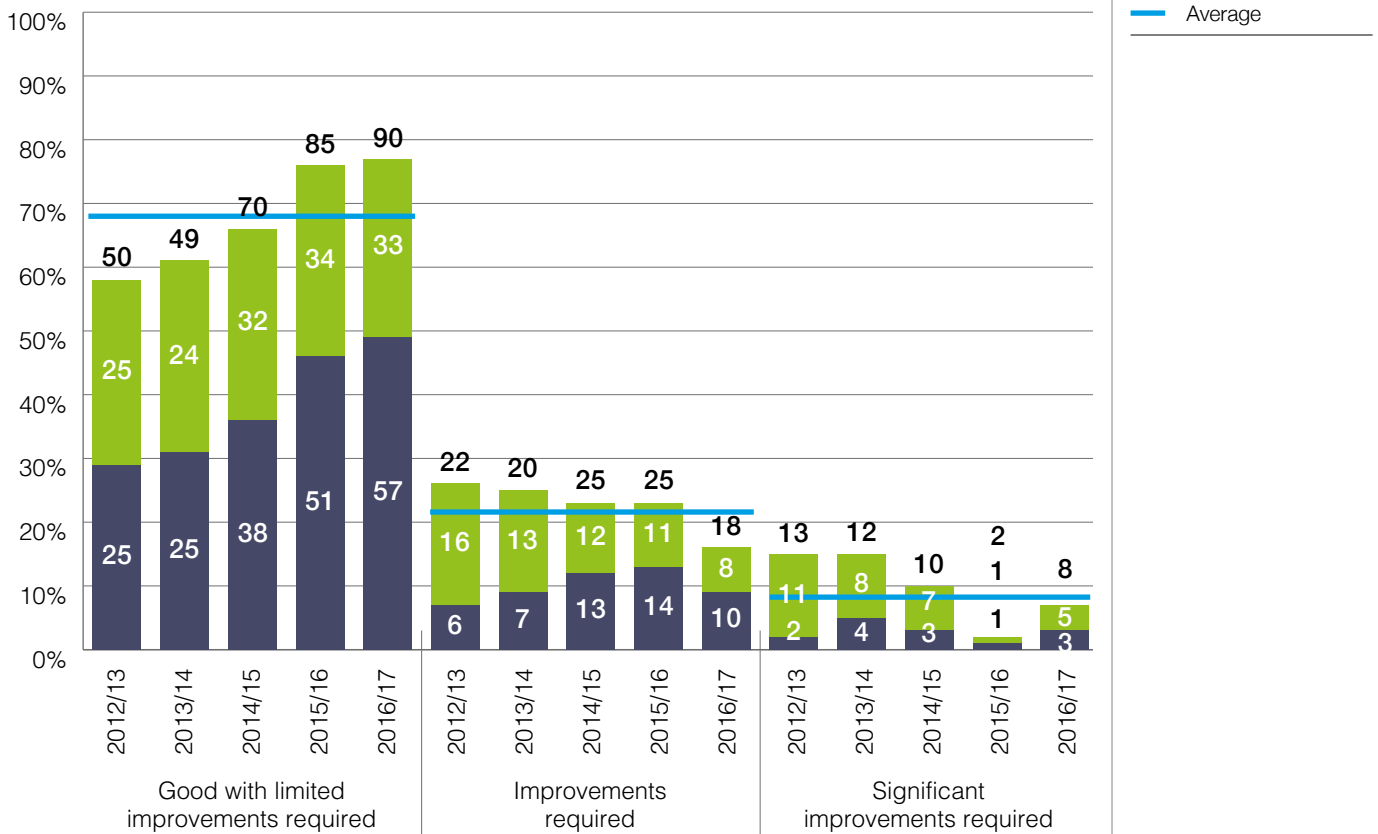
Auditors carrying out high quality audit act with integrity and objectivity, are demonstrably independent and do not act in a way that risks compromising stakeholders' perceptions of that independence.

High quality audit...clearly demonstrates how it reflects investor and other stakeholder expectations, is driven by a robust risk assessment informed by a thorough understanding of the entity and its environment, and provides challenge, transparency and insight in a clear and unambiguous way.

UK and Crown Dependency audit firms: assessment of audit quality

The following graph [graph 16] provides an overview of our assessment of the quality of UK and Crown Dependency audit work inspected in 2016/17, with comparatives for the previous four years. The graph also shows the five year average for each of the reported audit quality categories.

Graph 16: Audit Quality Categories: All Firms



Through our monitoring of audits undertaken by UK and Crown Dependency audit firms, we have observed:

- Improvement in the quality of audit work in 2016/17, with 78% of UK and Crown Dependency audits assessed as either good or only requiring limited improvements. This compares with 76%, 67%, 60% and 59% respectively in each of the preceding four years;
- The quality of FTSE 350 audits assessed in 2016/17 improved for the fifth consecutive year with 81% categorised as either good or requiring limited improvements (77%, 70%, 69% and 68% respectively in the previous four years);
- The proportion of FTSE 100 audits assessed in 2016/17 as either good or requiring limited improvements was 92%. This compares with 65% in 2015/16. No FTSE 100 audits were assessed as requiring significant improvement;
- A slight dip in the assessed quality of audits outside the FTSE 350,

for which 72% were assessed as either good or only requiring limited improvements (74%, 63%, 53% and 48% respectively).

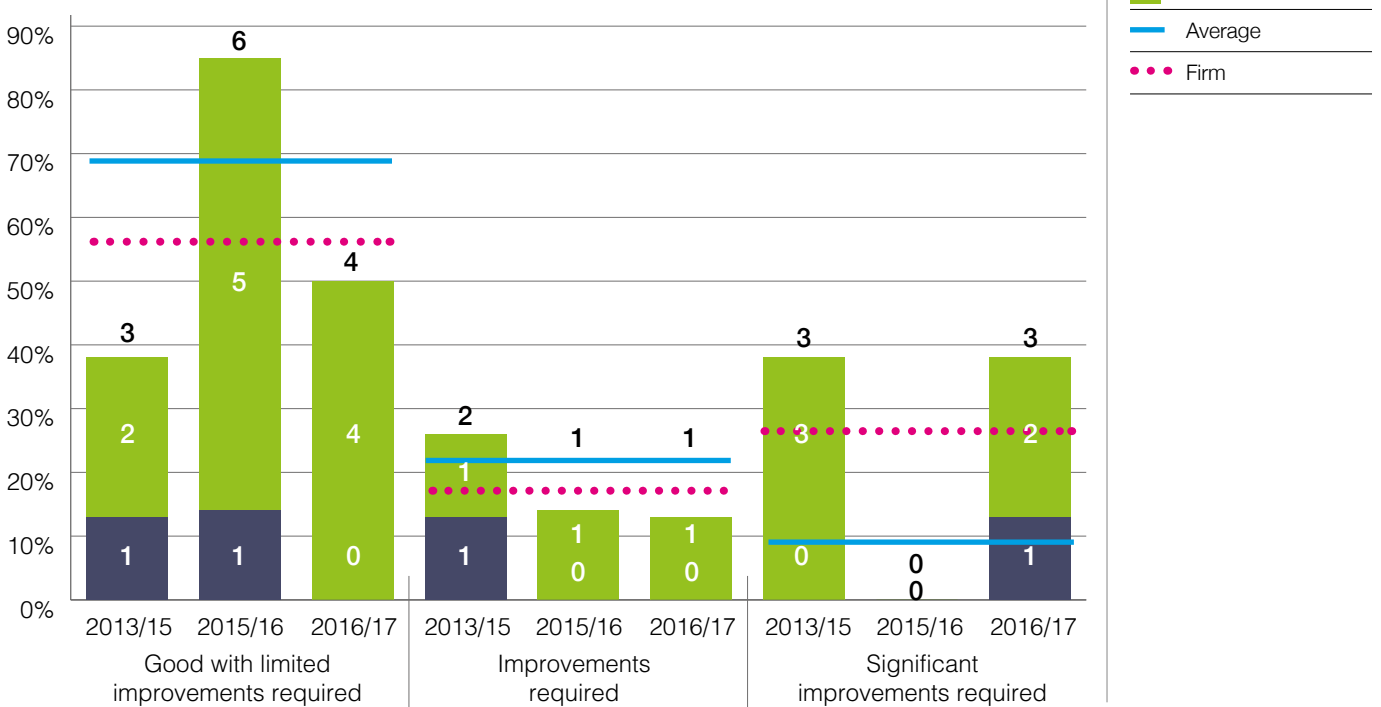
- 8 audits were assessed as requiring significant improvements. This compares with 2 in the prior year. There were no common factors underlying the assessment of audit quality.

Analysis by firm

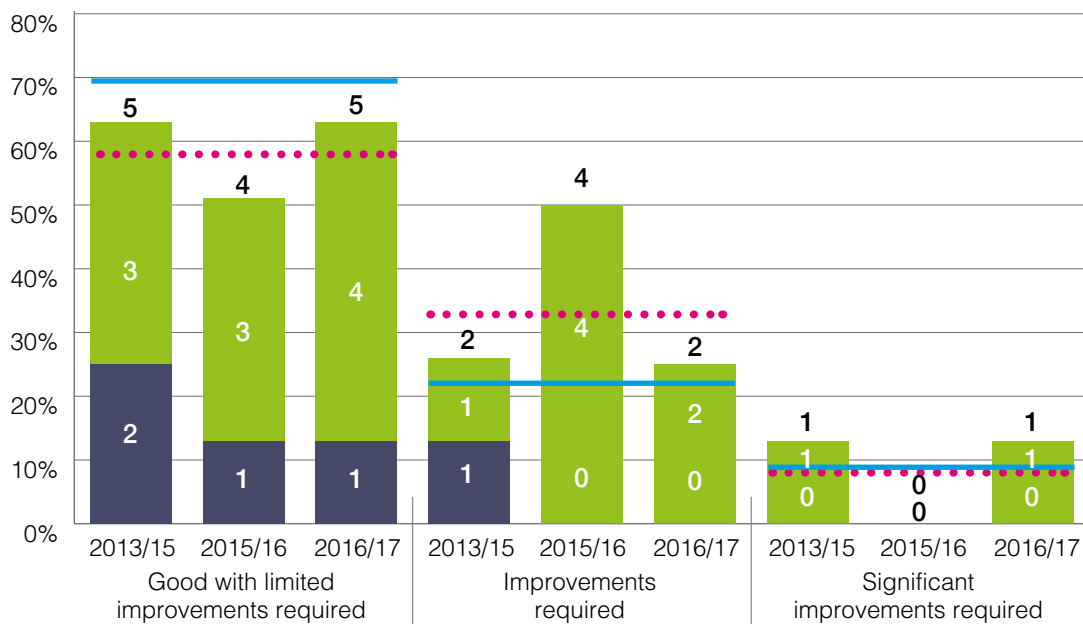
The following graphs [graphs 17-22] provide, on an individual firm basis, our assessment of the quality of the individual audits inspected. This analysis relates to the six firms where a separate inspection report was published in June 2017 and therefore does not include all audits reflected in the overall graph above.

In respect of the Big Four firms the analysis covers the last five years. For BDO LLP and Grant Thornton UK LLP these firms have only been subject to annual inspections since 2014/15. The analysis provided therefore covers the last three inspection periods with the earlier inspection covering a two year period (2011-13).

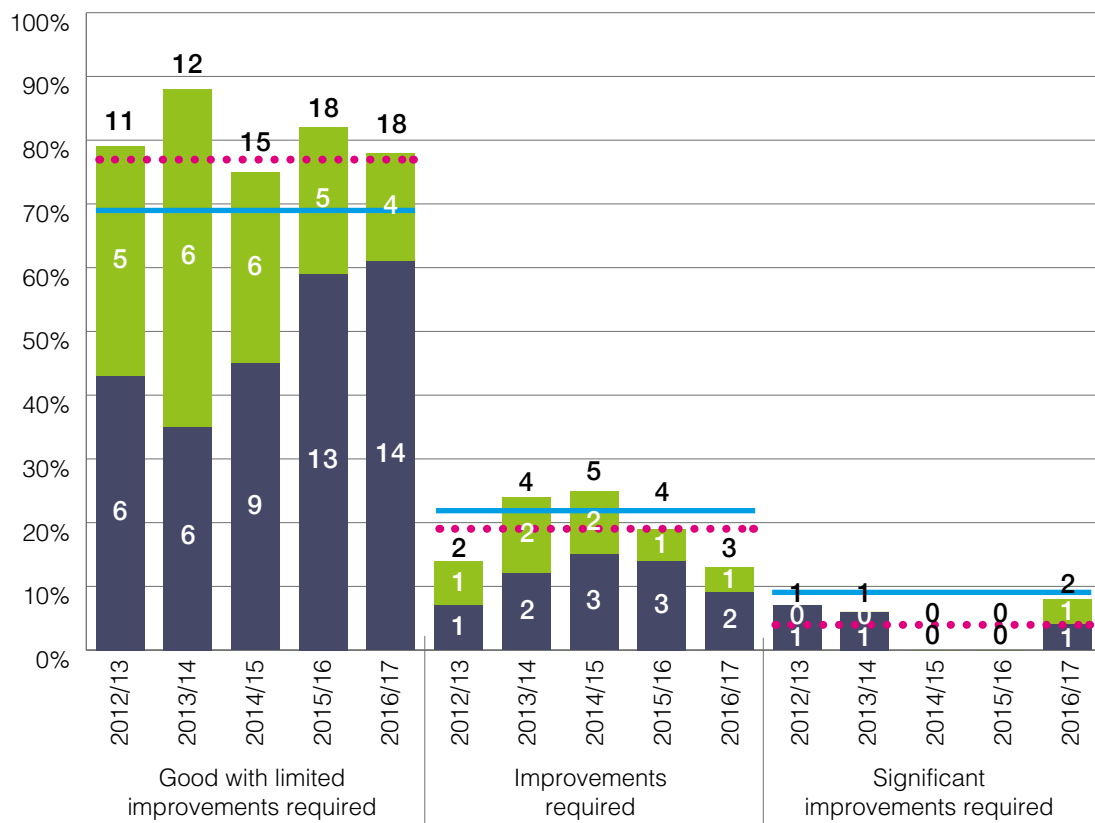
Graph 17: Audit Quality Categories: GT



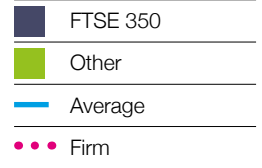
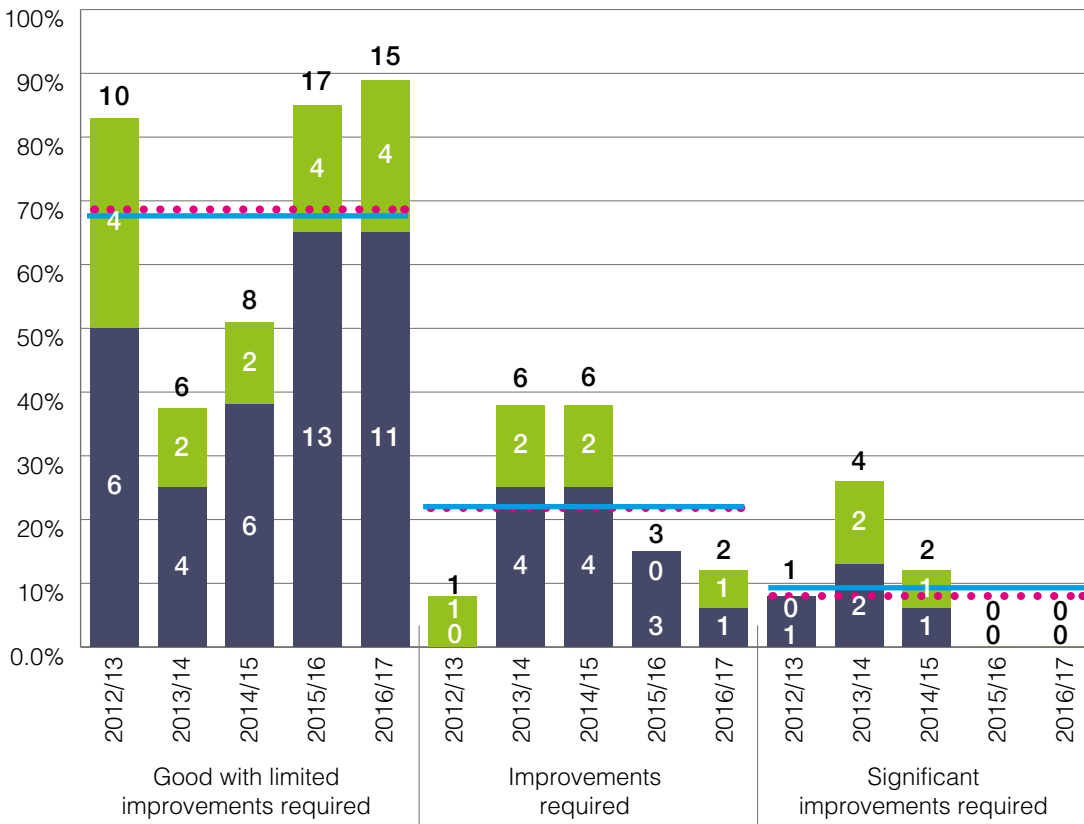
Graph 18: Audit Quality Categories: BDO



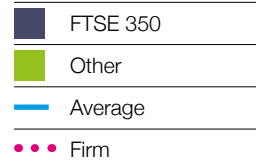
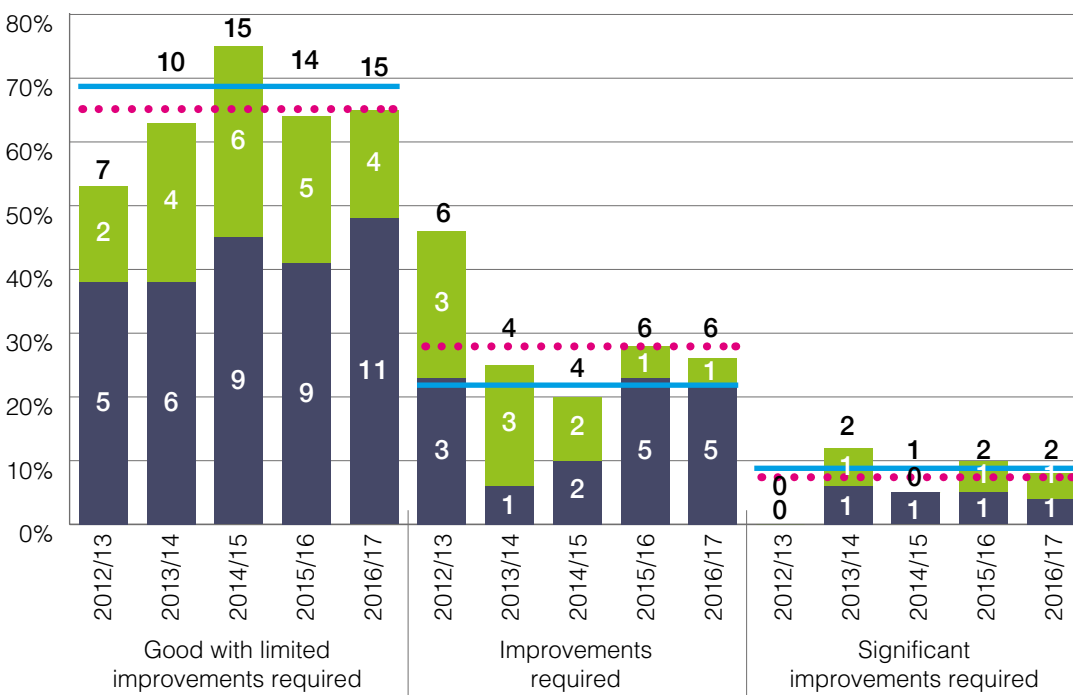
Graph 19: Audit Quality Categories: Deloitte



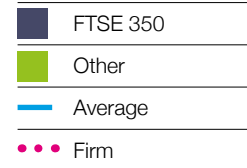
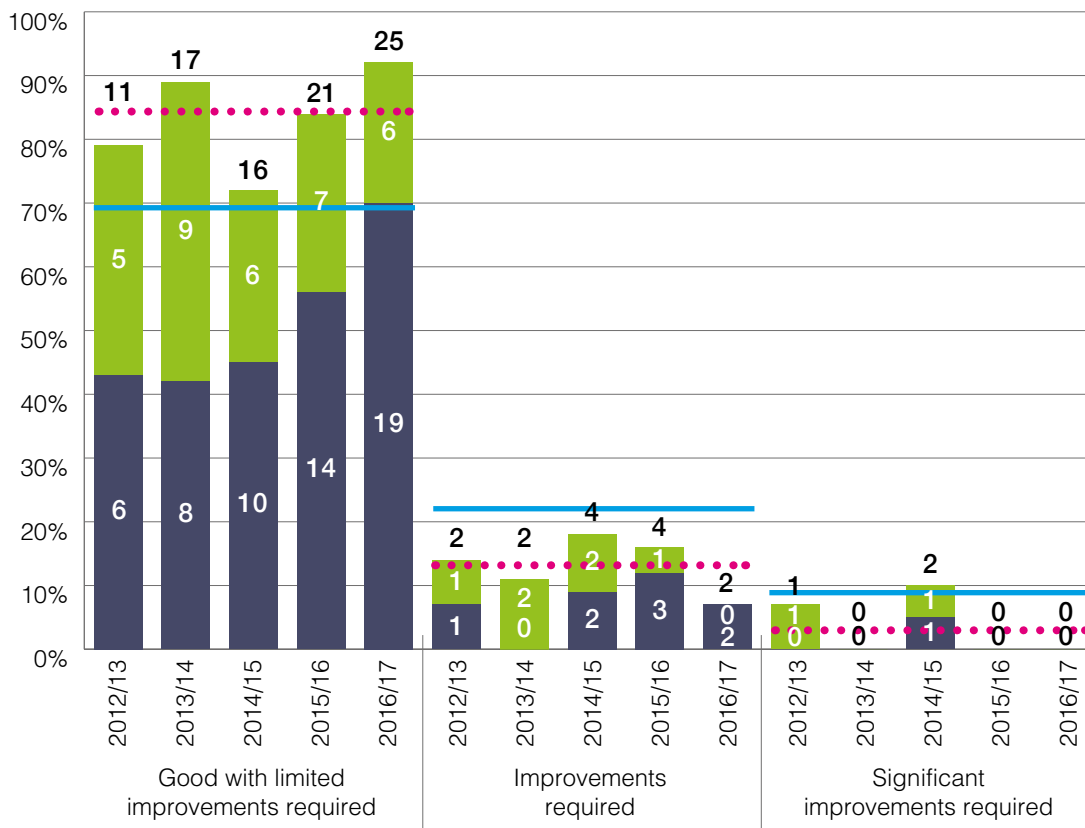
Graph 20: Audit Quality Categories: EY



Graph 21: Audit Quality Categories: KPMG



Graph 22: Audit Quality Categories: PwC



Changes to the proportion of audits falling within each category from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For this reason, and given the sample sizes involved, changes from one year to the next are not necessarily indicative of any overall change in audit quality at the firm.

The five year averages (both the overall five year average and the firm's own five year average) are, however, inevitably determined with a larger sample and are less volatile and therefore more reliable in assessing the audit quality of individual firms.

FTSE 350 inspection results

The FRC's strategy for 2016/19 includes a target for improvement in audit quality such that by 2019 at least 90% of all FTSE 350 audits inspected are assessed as good or requiring limited improvements.

- The results to date show that good progress is being made (81% in 2016/17 from 77% in 2015/16) towards our objective that 90% of FTSE 350 audits should be assessed as good or requiring limited improvements.
- The number of FTSE 350 audits inspected increased at the majority of the Big Four Firms but remained consistent at both BDO LLP and Grant Thornton UK LLP, where one FTSE 350 audit was inspected at each firm. The latter two firms perform a limited number of FTSE 350 audits.



UK and Crown Dependency audit firm inspection findings

At the conclusion of the inspection of an individual audit engagement, we report on our findings to the audit firm and to the Audit Committee of the company concerned to enable them to take action, where appropriate. The number of findings reported will depend on the quality of the audit work and the complexity of the key areas of audit judgement.

Set out below is an analysis of the findings reported in respect of the 116 audits inspected in 2016/17 (2015/16: 113).

Table 6

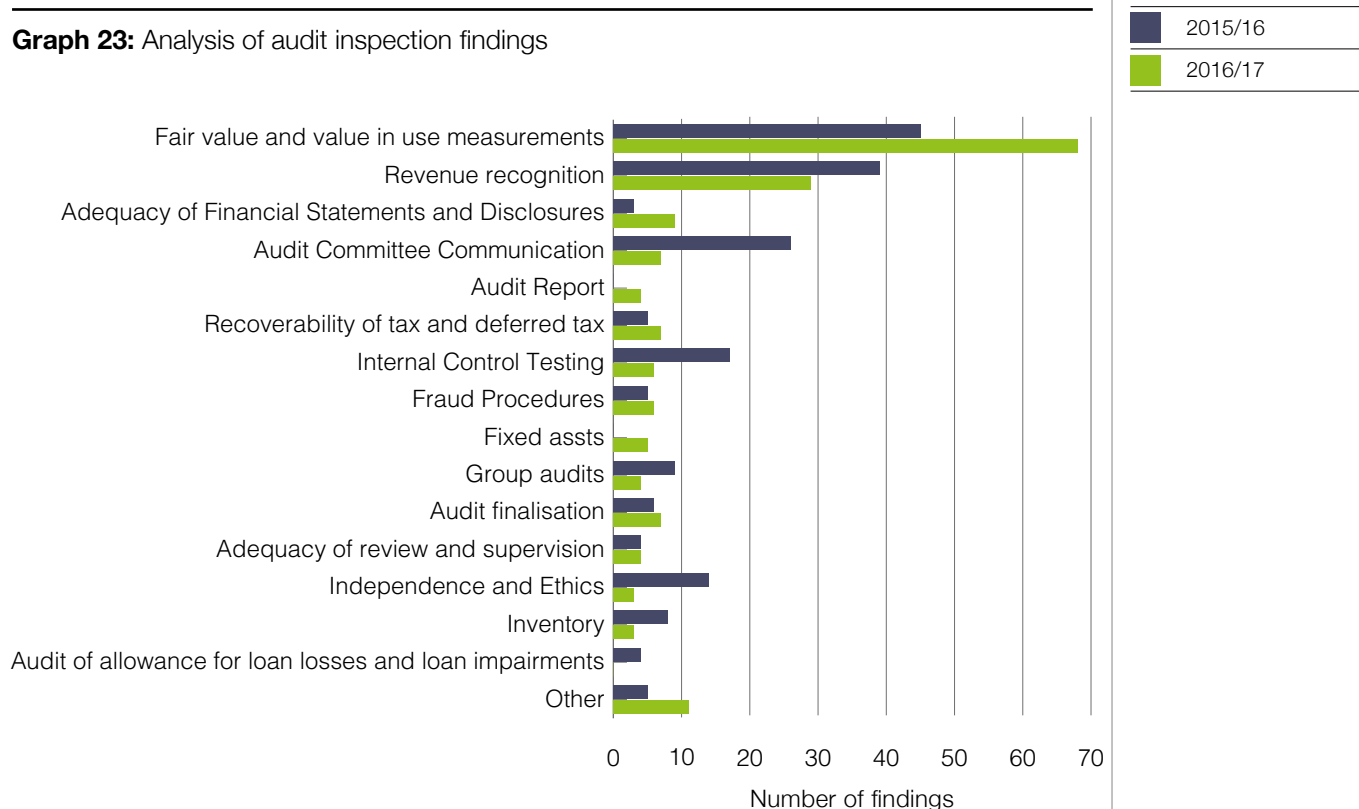
Inspection findings overview	2016/17	2015/16
Audits where no findings reported	26	28
Audits where findings reported	90	85
Total number of audits reported on (excluding third country and public sector)	116	113

Good practice

During the course of our reviews we also look for areas of good practice and, where identified, include these in our report to the Audit Committee. We believe strongly that learning from work that has been carried out well will support improvement in audit quality in the same way that responding to identified shortcomings. In the 16/17 inspection cycle we noted the following areas of good practice on one or more audits inspected (There is a degree of duplication with our previous analysis of report findings, which reflects the fact that we found examples of good practice on some audits which were areas of relative weakness on others):

- The extent of involvement of senior team members in key aspects of the audit, including in the planning and review processes.
- The interaction of the audit team with both the firm's and management's specialists, including robust reporting by the firm's specialists to audit teams in areas of judgment.
- A high standard of design and direction of the component auditors' work over significant risks.
- The evaluation of IT control weaknesses and resulting additional detailed testing required and the IT controls work related to the valuation of financial instruments (two financial services audits). The quality of written communications with Audit Committees.
- Effective use of data analytic techniques in the audit of revenue and journals.
- High quality reporting to the Audit Committee in relation to property valuations.
- An effective audit of key management judgments made in relation to uncertain tax provisions, including effective use of tax specialists.

Graph 23: Analysis of audit inspection findings



- The number of audits inspected where no findings were reported has marginally reduced from the prior year.
- The number of inspection findings reported has reduced further and is on average less than two per audit inspected.
- Fair value and value in use measurement continues to be the most common area in which we have found matters to be reported.

Five areas which account for approximately 64% of the findings reported are:

- a) Fair value and value in use measurements (39 %) - This category of finding broadly relates to the audit of impairment testing and investment property valuations;
- b) Revenue recognition (17 %);
- c) Audit Committee communication (4%); and
- d) Audit Report (2%).
- e) Independence & Ethics (2%)

Fair value and value in use measurements

An appropriate level of challenge of management and professional scepticism are essential to achieve high quality audit of key judgement areas concerning fair value and value in use measurements. Audit teams need to assess management's key assumptions and compare them to available audit evidence. They should also, where appropriate, challenge management's basis for those assumptions. We identified findings in this area at five of the six firms inspected in 2016/17.

We have continued to see insufficient scepticism applied by audit teams in challenging the appropriateness of key assumptions. We noted a number of examples where audit teams failed to challenge management assumptions in relation to profit forecasts, increases in market share, cash flow projections and discount rates. The targeted involvement of experienced senior staff is fundamental to address this issue through rigorous and

detailed challenge of management's key assumptions and judgements underpinning fair value calculations.

Revenue recognition

Our findings concerning revenue recognition continue to cover a wide range of revenue types and audit procedures. Common themes, however, centred on inappropriate or insufficient work. Weaknesses have included lack of precision in setting expectations for substantive analytical procedures, insufficient testing of accrued income and failure to perform planned procedures over customer contracts.

We noted in last year's report firms' increased use of data analytics tools to support their audit of revenue. We have seen examples of effective and targeted application of data analytics this year when auditing revenue, properly supported by appropriate testing to provide assurance over the completeness of revenue. We did, however, identify insufficient testing over key cash reconciliations upon which data analytics rely. We would encourage firms' effective and consistent application of these procedures.

Audit committee communication

Auditors need to communicate relevant matters clearly to Audit Committees, to assist them in overseeing the financial reporting process, assessing management's significant judgements and discharging their governance responsibilities. Effective communication also helps both auditors and Audit Committees focus on the key areas of risk and judgement most likely to affect the financial statements.

Consistent with our inspection findings in recent years, we continued to see examples of inadequate communication with those charged with governance across a variety of issues: internal control deficiencies, reporting on key areas of judgement in relation to impairment assessments and insufficient discussion of the adequacy of financial statement disclosures.

We have continued to see insufficient scepticism applied by audit teams in challenging the appropriateness of key assumptions. We noted a number of examples where audit teams failed to challenge management assumptions in relation to profit forecasts, increases in market share, cash flow projections and discount rates. The targeted involvement of experienced senior staff is fundamental to address this issue through rigorous and detailed challenge of management's key assumptions and judgements underpinning fair value calculations.

Independence and ethics

High quality audit complies with both the spirit and the letter of regulation and... provides a strong deterrent effect against actions that may not be in the public interest, underpins stakeholder confidence, and drives continuous improvement.

The Ethical Standards in place at the time of our inspections required firms to establish policies and procedures to ensure that firms, and all those in a position to influence an audit, acted with integrity, objectivity and independence. Furthermore, Auditing Standards require firms to establish policies and procedures to provide reasonable assurance that they and their personnel comply with relevant ethical requirements.

In 2016-17, we identified substantially fewer ethical and independence issues through our work. Those that we did identify included the failure to consult with ethics partners on the level of non-audit fees and late approval of non-audit services. We also noted a number of prohibited investment breaches where partners and staff held investments in audit clients.

We accept that firms are taking actions to address breaches in Ethical Standards and that levels of compliance are generally improving. We remain focussed on how firms apply the principles underpinning the Ethical Standard in the public interest.

As noted in last year's report, the ARD has strengthened certain independence requirements which place increased restrictions on the services which can be provided to audit clients. We are currently assessing, as part of our 2017/18 inspection cycle, how firms are ensuring compliance with the new standards.

Auditor reports

Extended auditor's reports have improved the transparency of the audit procedures performed in response to those Key Audit Matters identified by auditors. It is important to ensure that the procedures

performed are described accurately, so that users of the financial statements are properly informed of the audit approach taken to respond to those risks.

We have seen improvements in the drafting of extended reports since we first commented on their introduction in our 2014/15 inspection cycle. We continue, however, to identify findings concerning the accuracy of the description of the audit procedures performed. Our principal findings concerned an audit report implying that more procedures were carried out, and greater assurance obtained, than was the case in practice and two instances where it was unclear how the described critical assessment or focus of testing matched the work performed.

Engagement with Audit Committee chairs

A separate section of this report highlights the critical role of Audit Committees in overseeing and monitoring audit quality. Closer engagement with Audit Committees is therefore a key AQR objective. For a number of years, we have provided the confidential reports on each of the audits reviewed directly to the relevant Audit Committee chair or, where there is no Audit Committee, to those charged with governance of the audited entity. These reports are provided at the same time as they are provided to the audit firm.

We also engage with Audit Committee Chairs (ACC) at the beginning of our review. This helps us plan certain aspects of the review and provides an opportunity for Audit Committees to draw matters to our attention and also allows ACC's to better understand what we do. We invite Audit Committee chairs to discuss our findings with us following the receipt of our report on the inspection of their respective audit, irrespective of the nature of our findings. Increasingly Audit Committees are taking up this offer.

We also seek specific feedback from Audit Committees on each audit we inspect through completion of a short online survey. The survey provides an opportunity to comment on the style and content of our

We accept that firms are taking actions to address breaches in Ethical Standards and that levels of compliance are generally improving. We remain focussed on how firms apply the principles underpinning the Ethical Standard in the public interest.

reporting, usefulness of our review findings, our engagement with the Audit Committee chair and how the Audit Committee and its auditor address our findings. The feedback obtained from this survey will assist us in improving the effectiveness of our reviews and how we communicate our findings.

The survey has had a good response rate to date and the overall messages are positive, specifically in respect of

- The usefulness of the reporting to Audit Committees in discharging their responsibilities;
- The style of reporting and messaging; and
- The response of auditors in discussing with Audit Committees the findings identified in an AQR review.

A number of Audit Committees chairs commented in their response on the reassurance that they took from the review findings.

Interaction with Audit Committees is key to AQR achieving its continuous improvement strategy and will continue in the 2017/18 inspection year. Audit Committees are increasingly providing commentary in their annual reports on how AQR has informed their assessment of the quality of external audit, and how they have dealt with issues arising:

During the year an Audit Quality Review Team (“AQRT”) from the FRC undertook an inspection of EY’s audit of the Group’s 2015 financial statements. As part of that process the Chairman met with the inspection team to share his and the Board’s perspectives on the quality of EY’s audit and its delivery on commitments made by the audit firm as part of the audit tender process. On completion of the review the Audit and Risk Committee considered the AQRT’s final report on its inspection and discussed it with the audit partner. The Audit and Risk Committee was pleased with the overall assessment which was consistent with its own view on the quality and effectiveness of the 2015 audit.⁵⁵

In addition, the FRC will publish a list of the audits we have reviewed.

Firm-wide inspection findings

Our firm-wide inspection work comprised a review of firms’ policies and procedures supporting audit quality. The following findings were raised at two of the six firms.

Finding: *Matters considered when promoting or appraising staff:* audit quality needs to be given sufficient weight when promoting and appraising audit staff to emphasise its importance and to drive improvements in audit performance. We noted instances where: the promotion of a senior member of staff failed to consider adequately their involvement in an audit which we recently assessed as category 3 (significant improvement required); and key information was not always included on staff appraisal forms (such as comments from appraisers, a detailed self-assessment and relevant references to adverse internal and external inspection quality ratings).

Finding: We also found an instance where an audit team did not comply with the firm’s internal quality review procedures as the technical review approval occurred after the signing of the auditor’s report.

Audit Quality thematic reviews

Thematic reviews supplement our annual inspections of individual audit firms. In these reviews we look in detail at firms’ policies and procedures in respect of specific aspects of audit and their application in practice, to make comparisons between firms with a view to identifying good practice and areas of common weaknesses. The reviews are deliberately narrow in scope, and are chosen to focus on an aspect of audit in greater depth than is generally possible in our inspections, or because our inspection findings have suggested that there is scope for improvement in the area concerned. During 2016, we undertook thematic reviews to consider audit firms’ audit quality control procedures and other audit quality initiatives, root cause analysis and the use of data analytics in the audit of financial statements. Six firms participated in these reviews.

Interaction with Audit Committees is key to AQR achieving its continuous improvement strategy and will continue in the 2017/18 inspection year.

⁵⁵ SAGE Annual Report and Accounts 2016, p.80

Firms' audit quality control procedures and other audit quality initiatives

High quality audit...is supported by rigorous due process and quality assurance.

This thematic review considered the firms' procedures and resources for ensuring audit quality, some of which go beyond those required by standards. The review identified a number of areas of good practice including:

- Setting out audit quality procedures in a 'three lines of defence' model;
- Dedicated boards or committees to oversee all matters relating to audit quality;
- Ensuring firm leadership gives sufficient prominence to audit quality has specific.

Audits with a higher level of partner and director involvement had a greater likelihood of achieving a high quality outcome prior to issue of the audit report.

It is worth noting however that a significant number of audits included within our thematic were relatively poorly rated in our inspection findings – indicative of inconsistent or poor quality procedures.

To achieve faster improvements in, and greater consistency of, audit quality, strong leadership and the right firm culture are required. We identified certain firm procedures that should be a focus for audit quality improvements including the appropriate involvement of specialists in the audit with sufficient reporting of their work and considering whether there are any insights arising from their root cause analysis where their quality control procedures could be enhanced to further improve audit quality.⁵⁶

Root cause analysis (RCA)

This review considered the root cause analysis work performed by audit firms relating to audit inspection findings. RCA helps to identify the underlying causes of matters affecting audit quality. Importantly, it provides a better understanding of how audits can improve and enables firms to implement targeted actions to help prevent

problems recurring. It can also be used to understand better the key characteristics of an audit that went well, and what can be learned from it.

The review identified that all firms are improving their RCA processes and some are more advanced than others. We recommended that the firms improve planning and training in this area, consider using individuals and RCA techniques from outside the audit practice and adopt more consistent processes for investigating the cause for issues identified in internal and external inspections.⁵⁷

The Use of Data Analytics in the Audit of Financial Statements

UK audit firms are at the forefront of developing and using data analytic techniques. These have the potential to improve audit quality but a more structured approach to their deployment could accelerate their effectiveness. The findings of our review have been shared with international standard setters as they consider whether or how auditing standards need to develop to facilitate the effective use of data analytic techniques on audits.

This thematic review identified that the use of data analytic techniques is not yet widespread and gives examples of good practice identified during the course of FRC audit inspections. Examples include:

- Enabling audit staff to build experience and confidence in using a specific audit data analytics tool through a structured roll-out programme.
- Using data analytics during an interim audit to obtain robust audit evidence at the financial year end.
- Improving the effectiveness and efficiency of the extraction of entity data into audit data analytics tools by using dedicated specialist staff and/or dedicated software.
- Enabling data analytic techniques to improve oversight and consistency of multiple auditors contributing to group audits where organisations have global accounting systems.⁵⁸

Audits with a higher level of partner and director involvement had a greater likelihood of achieving a high quality outcome prior to issue of the audit report.

It is worth noting however that a significant number of audits included within our thematic were relatively poorly rated in our inspection findings – indicative of inconsistent or poor quality procedures.

⁵⁶ [https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Firms-audit-qual- \(1\).pdf](https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Firms-audit-qual- (1).pdf)

⁵⁷ <https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Root-Cause- Analysis.pdf>

⁵⁸ <https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-The-Use-of-Data- Ana.pdf>

Third Country Auditor inspections

Third Country Auditors (TCAs) are auditors of companies incorporated outside the EEA that have issued securities on EU regulated markets, which in the case of the UK means the main market of the London Stock Exchange. The regulation of TCAs under the ARD is one of the responsibilities delegated by the Government to the FRC.

Our regulation work includes registering audit firms as TCAs in the UK, and independent inspection of their relevant audit work. We are required to undertake inspections of TCAs from countries where the European Commission has determined that the system of auditor oversight is not “equivalent” or “transitional” to that required within the EU. These are known as “Article 45” TCAs.

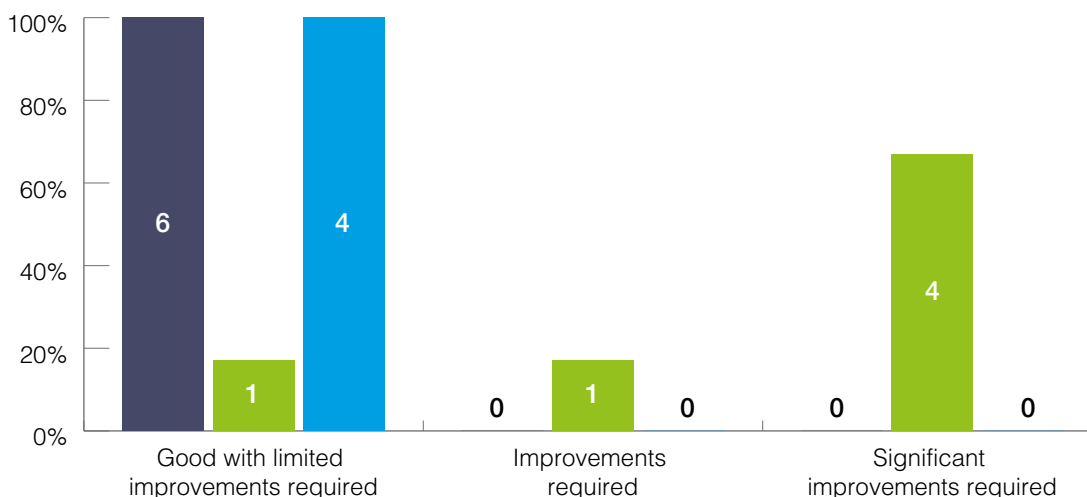
At 31 March 2017 there were 102 TCAs including those from equivalent or transitional countries, with 169 issuers with UK traded securities across 41 Countries. At the same date there were 41 Article 45 TCAs from 20 countries who audited 41 issuers with UK traded securities. We commenced inspections of Article 45 TCAs in 2013/14.

In 2016/17 six audits were inspected, one at each of the following firms:

- Price Waterhouse & Co S.R.L., Argentina;
- KPMG, Nigeria;
- PwC, Nigeria;
- PricewaterhouseCoopers Central Asia & Caucasus BV Georgia Branch;
- Kost, Forer, Gabbay & Kasierer, Israel; and
- Brightman, Almagor, Zohar & Co, Israel

The following graph (graph 24) summarises our assessment of the quality of audits inspected in the last three years.

Graph 24: Assessment of Audit Quality – 3 year summary



The comparability of the results is limited given the different firms and locations inspected each year. All of the TCA audits inspected in 2016/17 were assessed as good or requiring limited improvements. Of the six audits inspected, findings were formally reported in respect of five audits (five audits in 2015/16).

RSB Monitoring: Trends in audit quality

In addition to the audit monitoring we carry out for PIE audits, the RSBs are responsible for monitoring and inspecting a range of audits and audit firms. Both the statute implementing ARD and the delegation agreements with the RSBs require that the activities undertaken by each registered audit firm should be monitored at least once every six years. The RSBs are also required to take into account the risks surrounding the audit firm and schedule monitoring visits accordingly.

The RSBs use various criteria to determine which firms should be visited in a particular cycle. Factors include; the size/ complexity of the audit firm and of its audit clients, the firm's regulatory history, past review outcomes, and current circumstances.

In 2016 the RSBs conducted 1,090 audit monitoring visits to firms, and as part of these visits reviewed 1,928 audit files.

The results of the audit monitoring visits show that there has been an improvement in audit file grades between 2014 and 2016, with the percentage of audit files having the highest grade awarded increasing from 18% to 21% in this period. The percentage of the lowest grade awarded to audit files decreased over this period from 17% to 13%.

The RSBs highlight that the population of firms, and therefore audit files, reviewed by each RSBs differs each year because of the cyclical nature of the selection process. The RSBs therefore find it difficult to draw meaningful overall conclusions on changes in audit quality of in respect of the audit forms they monitor.

For 2016 the most common weaknesses and themes identified by the RSBs at their monitoring visits were:

- In some cases Annual Compliance Reviews were found to be ineffective, as they were not carried out in line with requirements or the firm did not implement timely corrective actions.
- On the audit files of specialist or regulated clients, it was found in some cases that the audit procedures were not to be tailored to the client's specific requirements. It was also found that there was lack of adherence to the planned audit procedures or a weaknesses in documentation of audit work performed.
- At the planning stage weaknesses were found on the documentation of compliance with ethical standards, understanding of client systems and related parties. The RSBs also found that some files would have benefited from a clearer explanation of the audit approach and the level of reliance on controls.
- Issues were found in relation to the audit evidence obtained mainly in the areas of revenue, fixed assets and stock. For audits which incorporated group audits, it was found that often information from component auditors was not always sufficient to support the group opinion.
- The RSBs also found that on some audit files, firms were over relying on accounts production software, and not performing sufficient audit procedures to ensure the disclosures were correct.

Toward the end of 2016, the RSBs' monitoring visits included audit files for accounts which were prepared under the new UK accounting standard, FRS 102 which was mandatory from 1 January 2015. The type of issues found included; disclosure omissions in the financial statements, audit fieldwork documentation issues, audit planning issues and documentation relating to the impact of transition. The RSBs expect the implementation of FRS 102 to continue to be a theme arising from their 2017 monitoring inspection visits.



One RSB carried out a review of a sample of audited financial statements filed at Companies House in order to obtain more evidence about the implementation of FRS 102. On the majority of financial statements reviewed the RSB found no issues or raised only minor queries.

Drivers of developments in audit quality and actions by the bodies

The RSBs collate the key themes from their audit monitoring activities and use this to feed back into their training activities for audit firms and audit personnel. The RSBs use a range of tools to promote audit quality at firms. These include publications and both face to face and online training courses which explore the key themes and results of the audit monitoring visits. The RSBs use these tools, and others, to support all firms in making improvements to audit quality.

The RSBs also specify follow up actions with firms when it is deemed necessary as a result of a monitoring visit. Actions may be in the form of conducting a monitoring visit sooner than would have otherwise been the case, or by a telephone based review. The form of follow up depends on the severity of the issues found during the

monitoring visit. The RSBs have found that, in most cases, this additional contact has led to an improvement in the audit quality at a subsequent audit monitoring visit.

As part of an audit monitoring visit the RSB considers whether the firm and its staff have undertaken sufficient CPD to meet the RSBs CPD requirements. At a small percentage of the audit monitoring visits conducted in 2016, the RSBs identified non-compliance with the requirements relating to CPD as an issue. However the RSBs have been unable to conclude whether a lack of appropriate CPD contributed to any deficiencies in audit work.

In recent years data analytics have been changing the way in which the larger audit firms carry out audits. The FRC and the RSBs are observing how this trend is developing in the smaller firms, and are taking an interest in the potential impacts on audit quality and audit judgment. They are also considering how monitoring and oversight will be conducted in the future. The bodies in their role as RQB's are also considering the future training needs of auditors and the effect this will have on the professional qualification and training provided.

PROFESSIONAL OVERSIGHT

The FRC has delegated tasks relating to the audit of non-PIE entities to the Recognised Supervisory Bodies (RSBs) via delegation agreements.

The responsibilities of the FRC's Professional Oversight Team (POT) and the RSBs have changed due to these new arrangements. As a result of a change in the definition of PIE, audits of certain types of entity that were previously within the FRC's scope in respect of audit quality monitoring and enforcement are now within the scope of the RSBs in respect of these matters. Such entity types include large private companies, large charities and large pension funds.

We set out the results of RSB monitoring work, and their assessment of trends in audit quality alongside the results of our own AQR inspections in a separate chapter of this report.

Education and skills developments

Auditors carrying out high quality audit act with integrity and objectivity, are demonstrably independent and do not act in a way that risks compromising stakeholders' perceptions of that independence.

International Education Standard 8 (IES8) issued by the International Accounting Standards Education Board and effective from 1 July 2016, sets out the learning outcomes that an audit engagement partner should achieve in order to demonstrate competence. IES 8 provides a framework for the professional bodies to monitor whether the audit engagement partner is meeting their CPD requirements. The professional bodies will consider whether Responsible Individuals are complying with IES 8 as part of their CPD reviews from 2017/18 onwards and have incorporated this into their inspection work programmes.

Several professional bodies have taken an active part in the development of the syllabus and assessment methods for accounting apprenticeships. These apprenticeships, developed under the government's Trailblazer apprenticeship scheme should improve access to the profession and provide a career path for non-graduates and for those working in accountancy who do not wish to seek a full professional level qualification. These apprenticeships allow for apprentices to be assessed on the basis of work experience rather than exams where their employer agrees. It is hoped that improving access will help ensure that the profession continues to attract the talented individuals that are required to work in an increasingly demanding audit environment.

The rotation of engagement partner rules and the requirements of international business mean that the ability to move key staff between countries is important for audit firms. One issue that arises is a lack of recognition of the qualifications of non-EU auditors and the time required for such individuals to meet EU requirements. The FRC and the RSBs continue to work with counterparts around the globe and the international accounting bodies with the aim of aiding the mobility of auditors across borders to facilitate audit quality.



Post Brexit the UK will want to continue to attract international capital, possibly leading to a corresponding increase in audit firms from non-EU countries that need to register with the FRC as Third Country Auditors. The FRC's work in this area gives some assurance to investors that the auditors of these companies meet the relevant standards (currently) defined by the EU.

Developments relating to other POT activities

The ARD introduces new requirements for transparency reporting by the auditors of PIEs. The new requirements include additional disclosures which must be included in the firm's annual transparency report. The additional disclosures provide further information for Audit Committees to assist them in making more informed decisions. The first transparency reports to be published under the new disclosure requirements are for audit firms with financial years which commenced on or after 17 June 2016.

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ENFORCEMENT AND CASE PROGRESS 2016/17

This Section provides an overview of the cases which have been investigated and taken forward by the FRC under the Accountancy Scheme and the Audit Enforcement Procedure (“AEP”).

The AEP came into effect 17 June 2016. We use the AEP to investigate allegations in relation to statutory audit matters which have not been delegated to the RSBs. These ‘Retained Matters’ broadly include audits of Public Interest Entities and AIM companies with a market capitalisation in excess of €200m.

Under the AEP, our investigation powers include the ability to:

- Compel information from any person involved in the activities of a Statutory Auditor
- Compel information from any Public Interest Entity (or subsidiary or parent)
- Compel information from any person having a connection to a Statutory Auditor carrying out the audit of the PIE
- Entry to premises in order to inspect audit work (with notice) The AEP also grants us civil and criminal powers for non-compliance.⁵⁹

In addition, the FRC operates the Accountancy Scheme, an independent disciplinary scheme for accountants and accountancy firms in the UK. This covers members of the main accountancy professional bodies. The FRC deals with cases of potential misconduct which might raise issues affecting the public interest in the UK.

Taking account of stakeholder feedback, and as we approach a one year anniversary as the Competent Authority for Audit, the FRC (FRC) has commissioned an independent review of the sanctions imposed under its enforcement procedures.⁶⁰

The review will consider matters such as whether the reasons for imposing sanctions set out in our guidance and policies remain appropriate, the fairness and the effectiveness of the range of sanctions available under the enforcement procedures, and whether the financial penalty sanctions, in particular, are adequate to safeguard the public interest and deter wrongdoing.

⁵⁹ Details of FRC investigation powers are set out in para 9 page 6 of the AEP: <https://www.frc.org.uk/Our-Work/Publications/Professional-Discipline/Audit-Enforcement-Procedures.pdf>

⁶⁰ The review will be conducted by an independent panel chaired by former Court of Appeal Judge, Sir Christopher Clarke, and will comprise Peter Chambers and Andrew Long who bring extensive subject matter and regulatory expertise.

Cases concluded in the current period

Company	Audit firm / Audit partner	Investigation Announced	Outcome	Date	Sanction	Costs
Cattles plc	PWC	23-Jul-09	Misconduct admitted Sanction agreed	22-Aug-16	Severe Reprimand Fine £2,300,000	£750,000
Cattles plc	Simon Bradburn	23-Jul-09	Misconduct admitted Sanction agreed	22-Aug-16	Severe Reprimand Fine £75,600	N/A
Aero Inventory plc	Deloitte	03-Mar-11	Misconduct by Tribunal Sanction by Tribunal	10-Nov-16	Severe Reprimand Fine £4,000,000	£2,275,000
Aero Inventory plc	John Clennett	03-Mar-11	Misconduct by Tribunal Sanction by Tribunal	10-Nov-16	Severe Reprimand Fine £150,000	N/A
The Cup Trust	Hillier Hopkins LLP	09-Dec-13	Misconduct admitted Sanction agreed		Reprimand Fine £100,000	£100,000
The Cup Trust	Philip Collins	09-Dec-13	Misconduct admitted Sanction agreed		Reprimand Fine £20,000	£20,000
Connaught plc	PWC	29-Nov-10	Misconduct by Tribunal Sanction by Tribunal	12-Apr-17	Severe Reprimand Fine £5,000,000	TBC
Connaught plc	Stephen Harrison	29-Nov-10	Misconduct by Tribunal Sanction by Tribunal	12-Apr-17	Severe Reprimand Fine £150,000	N/A
AssetCo plc	Grant Thornton	12-Aug-14	Misconduct admitted Sanction agreed	24-Apr-17	Severe Reprimand Fine £2,275,000	£200,000
AssetCo plc	Robert Napper	12-Aug-14	Misconduct admitted Sanction agreed	24-Apr-17	Three year exclusion Fine £130,000	N/A
Tesco plc	PwC	22-Dec-14	Case closed ⁶¹			

High quality audit...is driven by a robust risk assessment informed by a thorough understanding of the entity and its environment, and provides challenge, transparency and insight in a clear and unambiguous way.

⁶¹ FRC announced the closure of this investigation on 5 June 2017. The Executive Counsel concluded that there was not a realistic prospect that a Tribunal would make an Adverse Finding against PwC LLP and certain Members in respect of the matters within the scope of the investigation. <https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2017/June/Closure-of-investigation-into-the-conduct-of-membe.aspx>

Cattles plc

A settlement was agreed in August 2016 by PwC and Mr Bradburn, audit engagement partner, in relation to the audit of Cattles plc and Welcome Financial Services Limited. Both PwC and Mr Bradburn admitted that their conduct fell significantly short of the standards reasonably to be expected of a Member Firm and a Member in respect of their audit of the financial statements of both companies for the year ended 31 December 2007. These financial statements were restated in May 2010, indicating that income had been overstated by £42.6 million and loans and receivables had been overstated by £287.2 million.

PwC and Mr Bradburn ultimately agreed that in issuing unqualified audit opinions in respect of these financial statements, they:

- i) Had insufficient audit evidence as to the adequacy of the loan loss provision; and
- ii) Had failed to identify the fact that the impairment policy was not adequately disclosed and that the disclosures in those financial statements were not in compliance with IFRS 7.

The parties agreed to the following settlement: Both received a severe reprimand; PwC were fined £3,500,000 discounted for settlement to £2,300,000; and, Mr Bradburn was fined £120,000 discounted for settlement to £75,600. PwC also agreed to pay £750,000 as a contribution to the FRC's costs.

Aero Inventory plc

An independent tribunal heard three allegations in respect of the conduct of Deloitte LLP and the Deloitte partner, Mr John Clennett, in relation to the audit of financial statements of the AIM listed company Aero Inventory Plc and its subsidiary Aero Inventory (UK) Limited (together "Aero") for the financial years ended 30 June 2006, 2007 and 2008. Deloitte LLP were the auditors and Mr Clennett the Audit Engagement Partner for Aero.

Aero's shares were suspended in October 2009 when accounting errors were discovered in relation to reported inventory levels in its accounts. Aero went into administration in November 2009.

The three allegations brought to the tribunal concerned:

- The appropriateness of the accounting and disclosure in Aero's 2006 financial statements in relation to a purchase of aircraft parts worth £34 million.
- The costs of sales and stock valuations in the 2006, 2007 and 2008 audits.
- Stock existence in the 2007 and 2008 audits.

The tribunal found these allegations proved and that the conduct of Deloitte and Mr Clennett fell significantly short of the standards reasonably to be expected of, respectively, a Member Firm and a Member.

The Tribunal imposed the following sanctions: Both received a severe reprimand, Deloitte received a fine of £4 million and Mr Clennett received a fine of £150,000. Deloitte were also ordered to pay all the costs of the proceedings.

The Cup Trust

The FRC investigated the audit of the charity's financial statements for the years ended 31 March 2010 and 31 March 2011. Hillier Hopkins was engaged to carry out the audit, and Mr Collins was the engagement partner in each year.

Mr Collins and Hillier Hopkins have each admitted that their conduct fell significantly short of the standards to be expected of members of the ICAEW and amounted to breaches of the ICAEW's Fundamental Principles of Professional Competence and Due Care.

The parties agreed the following terms of settlement:

Mr Collins

- A reprimand;
- A fine of £20,000; and

- A sum of £20,000 to be paid as a contribution to the Executive Counsel's costs.

Hillier Hopkins

- A reprimand;
- A fine of £100,000; and
- A sum of £100,000 to be paid as a contribution to the Executive Counsel's costs.

Connaught plc

PwC and Stephen Harrison, a retired PwC audit partner, were severely reprimanded and fined £5m and £150,000 respectively for Misconduct in relation to the 2009 audit of Connaught plc, a FTSE 250 company which went into administration in 2010. The independent Tribunal, chaired by the Rt Hon Sir Stanley Burnton, made findings of Misconduct in relation to three areas of audit: mobilisation costs, long term contracts and intangible assets.

PwC were also ordered to pay the Executive Counsel's costs and to make an interim payment on account of £1.5 million.

The Tribunal stated:

"... the principal failures on the part of the Respondents were their almost complete failure to stand back, to heed the warning signs ... and to exercise any appropriate degree of scepticism in relation to management's proposed adjustments. In the areas we have considered, the audit function failed. ...

... We regard the Misconduct we have found to be very serious indeed. It has to be considered in the context of the audit of the financial statements of a public quoted company. Investors and creditors rely on those financial statements, and the auditor's report, in making their financial decisions. The responsibility of an auditor is in our view to be measured less by the amount of the audit fee than by the scales of the balance sheet and profit and loss account that it audits and on which it reports. Management may have every reason to overstate the profits shown by the profit and loss account, or to understate losses, to overstate assets and

to understate liabilities. They may seek to do so beyond what is objectively justifiable. It is crucial that the auditor reasonably satisfies itself that this has not happened."

AssetCo plc

Grant Thornton UK LLP ("GT") and Robert Napper (a retired GT Partner) admitted Misconduct and agreed to fines and other sanctions. This follows the conclusion of the FRC's investigation relating to the audits of the financial statements of the AIM listed company AssetCo plc for the financial years ended 31 March 2009 and 31 March 2010. GT were the statutory audit firm, and Mr Napper the Audit Engagement Partner.

GT and Mr Napper admitted that their failings arose as a result of the significant and widespread lack of professional competence and due care in the performance of the audits including:

- a) Failures to keep track of tasks and resolve outstanding queries, which led to confusion and some key information and issues being overlooked;
- b) Flawed judgments;
- c) Deficiencies in understanding; and
- d) Insufficient appreciation of audit risks.

GT and Mr Napper further accepted that the root cause of many of the defects in their audit work was a significant failing in the application of professional scepticism, which should be at the core of the work of statutory auditors.

The FRC's Executive Counsel brought a total of 12 allegations against GT and Mr Napper, concerning matters including:

- Disclosures in respect of related party transactions and restricted cash.
- Existence of significant amounts of finance lease debtors and related revenue, and measurement of substantial assets including investments in subsidiaries, goodwill and other intangible assets.
- Assessment of the going concern assumption in the financial statements.

... the principal failures on the part of the Respondents were their almost complete failure to stand back, to heed the warning signs ... and to exercise any appropriate degree of scepticism in relation to management's proposed adjustments. In the areas we have considered, the audit function failed. ...

- Failures to apply sufficient professional scepticism in relation to a variety of matters material to the financial statements.

The root cause of many of the defects in the audit was a significant failing in the application of professional scepticism, which should be at the core of the work of statutory auditors.

The parties have agreed the following terms of settlement:

GT – A Fine of £3,500,000, reduced to £2,275,000 after settlement discount, and a Severe Reprimand;

Mr Napper – exclusion from membership of ICAEW for 3 years and a Fine of £200,000, reduced to £130,000 after settlement discount.

A sum of £200,000 to be paid by GT as a contribution to the Executive Counsel's costs.

Lessons learned

Although some enforcement cases take a number of years to resolve, we do not therefore conclude that there is nothing to learn from the issues arising. There are recurrent themes, which we have touched upon throughout this report, including a failure by auditors to demonstrate sufficient professional scepticism, or to sufficiently challenge management in an independent and objective way. Examples of explanations given during investigations for failures by auditors to identify misstatements demonstrate why scepticism, independence and objectivity are so fundamental: "I think, to a degree, because we hadn't been looking for it there and because nobody had told us about it."

The learning and outcomes from our enforcement activity are therefore a key input to the risk assessment which drives our audit monitoring activity.

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Cases currently under investigation

Not all cases in the initial stages of investigation are made public. At the end of the main investigation work, a Formal Complaint is delivered to the Conduct Committee.

At the time when this report was published the following 17 cases were in the public domain:

Company	Auditor	Investigation Announced	Case Status
Tanfield Group ⁶²	Baker Tilly	04-Nov-10	Complaint issued 11-Jun-14
Equity Syndicate Management Limited	KPMG	06-Mar-12	Complaint issued 7-Sep-16
RSM Tenon	PWC	13-Aug-12	Complaint issued 14-Dec-16
Autonomy Corporation plc	Deloitte	11-Feb-13	Investigation ongoing
Nichols plc	Grant Thornton	06-Aug-13	Investigation ongoing
The Co-Operative Bank plc	KPMG	20-Jan-14	Investigation ongoing
Computer 2000 Distribution Limited	EY	12-May-14	Investigation ongoing
Quindell plc	KPMG	05-Aug-15	Investigation ongoing
Globo plc	Grant Thornton	21-Dec-15	Investigation ongoing
Serco Group	Deloitte	8-Jun-16	Investigation ongoing
HBOS plc	KPMG	27-Jun-16	Investigation ongoing
BHS Limited	PwC	27-Jun-16	Investigation ongoing
Sports Direct International plc	N/A ⁶³	28-Nov-16	Investigation ongoing
Redcentric plc	PwC	27-Feb-17	Investigation ongoing
Rolls Royce Group	KPMG	4-May-17	Investigation ongoing
BT Group PLC	PwC	29 Jun 17	Investigation ongoing

In almost every case, subjects include the audit firm and the audit engagement partner. These will generally be investigated under the AEP.

In some cases we also investigate those employed within companies. These investigations are performed under the Accountancy Scheme.

Current investigations include the accounting for and audit of:

- Long term contracts;
- Capitalisation of costs;
- Insurance syndicate's reserves;

- Related party disclosure
- Revenue recognition;
- Disclosure of a bank's capital requirements;
- Assessment of going concern; and
- Acquisition accounting.

We are currently investigating one case specifically as to whether the auditor was independent when it conducted its audits.

The level of cooperation received from firms under investigation varies considerably case by case and has a significant impact on the efficiency of the investigation.

⁶² This case had been stayed pending a judicial appeal. A judgement was handed down on 7th June 2017 allowing the case to proceed to a hearing in October 2017.

⁶³ In this case the auditor was not publicised.

Definition of Terms

<p>Committee of European Auditing Oversight Bodies (CEAOB)</p>	<p>The CEAOB is a new framework for co-operation between national audit oversight bodies at EU level. Its role is to strengthen EU-wide audit oversight, which is a key objective of the new EU legislation on statutory audit that took effect on 17 June 2016.</p> <p>The CEAOB is composed of representatives of the national audit oversight bodies of the EU the European Securities and Markets Authority (ESMA)</p> <p>Representatives of the national audit authorities of the European Economic Area also participate. The European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) are observers.</p>
<p>Public Interest Entity (PIE)</p>	<p>These are:</p> <p>(a) An issuer whose transferable securities are admitted to trading on a regulated market;</p> <p>(b) A credit institution within the meaning of Article 4(1)(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council, other than those listed in Article 2 of Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and investment firms;</p> <p>(c) An insurance undertaking within the meaning given by Article 2(1) of Council Directive 1991/674/EEC of the European Parliament and of the Council on the annual accounts and consolidated accounts of insurance undertaking. No other entities have been specifically designated in law in the UK as ‘public interest entities’.</p>
<p>Recognised Supervisory Bodies (RSBs)</p>	<p>The FRC delegates to the RSBs certain regulatory tasks, except those pertaining to ‘PIEs’. These include:</p> <ul style="list-style-type: none"> • Registration • Audit Monitoring (non-PIE) • Continuing Professional Development (‘CPD’) • Enforcement (non-PIE) <p>The FRC’s Professional Oversight team (POT) monitors the manner and extent to which the RSBs perform such delegated Regulatory Tasks in relation to those statutory audit firms and statutory auditors registered by the RSBs to perform statutory audit. The Delegation Agreements with the RSBs aim to promote the common aim of enhancing audit quality.</p>
<p>Technical Advisory Group (TAG)</p>	<p>An audit advisory group established by the FRC in 2016 to:</p> <p>a) advise the Audit and Assurance Council on the maintenance and improvement of the FRC Ethical Standard and International Standards on Auditing UK;</p> <p>b) consider issues referred to it by the Audit and Assurance Council, raised by members of the Group or brought to the attention of the Group by FRC staff including: issues relating to clarity or interpretation of ISAs (UK) or the FRC Ethical Standard; and the implications for UK Auditing and Ethical standards of developments in international auditing standards issued by the IAASB and the ethical Code issued by IESBA.</p>
<p>Third Country Auditors (TCAs)</p>	<p>Defined in Article 2(4) of the Statutory Audit Directive (“the Directive” - 2006/43/EC) and in Sections 1242 and 1261 of the Companies Act 2006.</p> <p>A third country audit firm must register with the FRC if it audits the annual or consolidated accounts of a company incorporated outside the European Union/ European Economic Area (EU/EEA) whose transferable securities are admitted to trading on a regulated market in the United Kingdom. However, no registration is required if the company is an issuer exclusively of debt securities within the meaning of Article 2(1)(b) of the Directive, the denomination of which is:</p> <ul style="list-style-type: none"> • At least EUR 50,000 per unit or, in the case of debt securities denominated in another currency, equivalent, at the date of issue, to at least EUR 50,000 (if issued prior to 31 December 2010); or • At least EUR 100,000 or, in the case of debt securities denominated in another currency, equivalent, at the date of issue, to at least EUR 100,000 (if issued on or after 31 December 2010).

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