Financial Reporting Council

KPMG LLP

AUDIT QUALITY INSPECTION

JULY 2019

The FRC

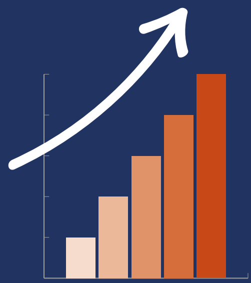
Our mission is to promote transparency and integrity in business.

We have responsibility for the public oversight of statutory auditors.

The FRC works with European, US and global regulators to promote high quality audit and corporate reporting.

AQR

We monitor the quality of UK Public Interest Entity audits.

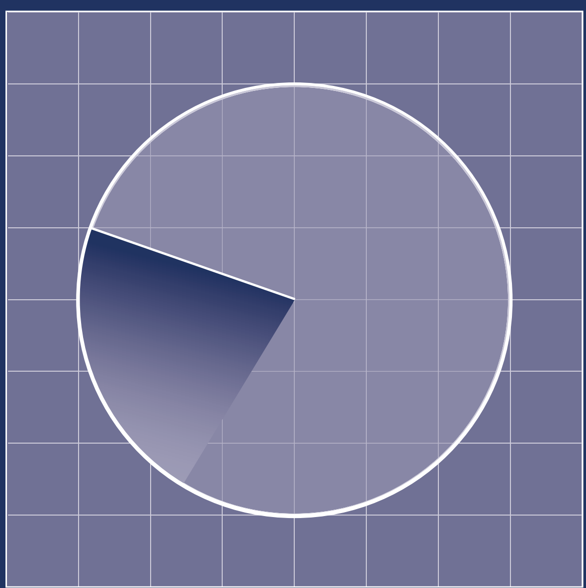


We promote continuous improvement in audit quality.

Our team of over 40 professional and support staff has extensive audit expertise to provide rigorous inspection of audit firms.

The Firm

KPMG has 549 audits within the scope of AQR inspection, including 26 FTSE 100 and 51 FTSE 250 audits.



Our inspection process

There are around 2300 audits within the scope of AQR inspection. In total, we inspected 160 individual audits in 2018/19, including 29 at KPMG.

We work closely with audit committee chairs to improve the overall effectiveness of our reviews.

We assess the overall quality of the audit work inspected.

Financial Reporting Council

KPMG LLP

Audit Quality Inspection

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

Contents

We consider whether action under the FRC's enforcement procedures is appropriate for all reviews assessed as requiring improvements or significant improvements. In practice, audits assessed as requiring significant improvement, and some of those assessed as requiring improvement, will be referred to the FRC's Case Examiner for consideration of further regulatory action. The Case Examiner will consider the most appropriate action, including Constructive Engagement with the audit firm or referral to the FRC's Conduct Committee for consideration of whether to launch a full investigation. This may result in a sanction being imposed and enforced against a statutory auditor and/or the audit firm in accordance with the FRC Audit Enforcement Procedure.

This report sets out the principal findings arising from the 2018/19 inspection of KPMG LLP ("KPMG" or "the firm") carried out by the Audit Quality Review team ("AQR") of the Financial Reporting Council ("the FRC"). We conducted this inspection in the period from February 2018 to February 2019 ("the time of our inspection"). We inspect KPMG, and report publicly on our findings, annually.

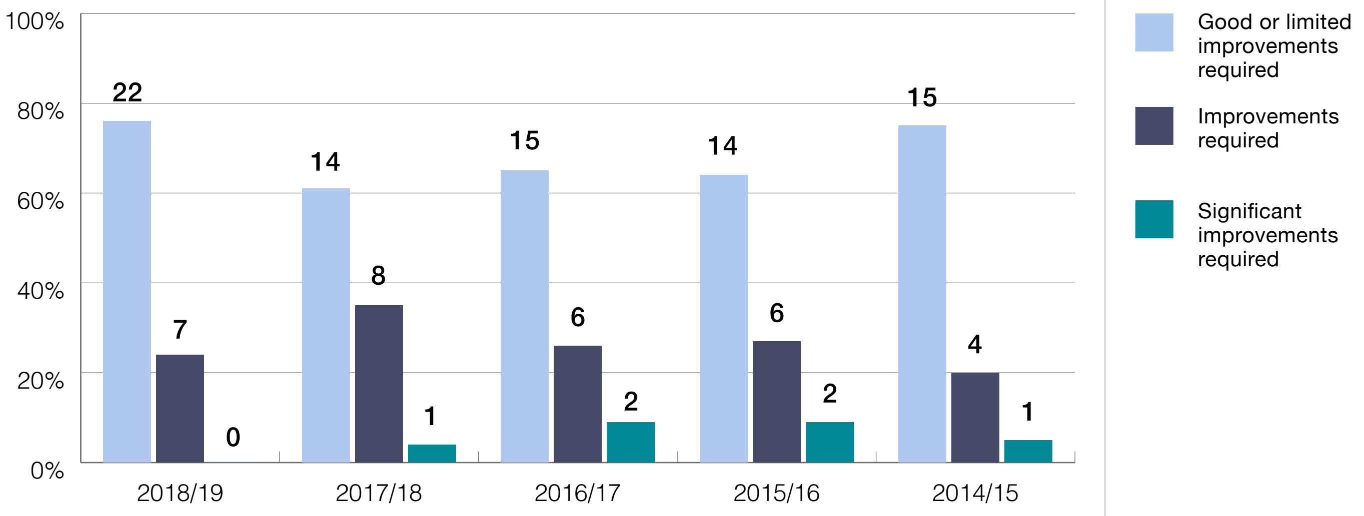
Our report focuses on the key areas requiring action by the firm to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the firm's audit work. Our findings cover matters arising from our reviews of both individual audits and the firm's policies and procedures which support and promote audit quality. This year, our firm-wide work, performed on a three year cycle, focused on internal quality monitoring, engagement quality control reviews, independence and ethics and the implementation of the firm's Audit Quality Transformation Programme ("Audit Quality Plan" or "plan").

Our priority sectors for inspection in 2018/19 were general retailers; oil and gas producers; support services companies; and financial services. Of the 139 audits that we reviewed in the year across all firms (excluding Local Audit inspections), the number in priority sectors was: General retailers (11); Oil and Gas producers (7); Support services (13); and Financial services (34).

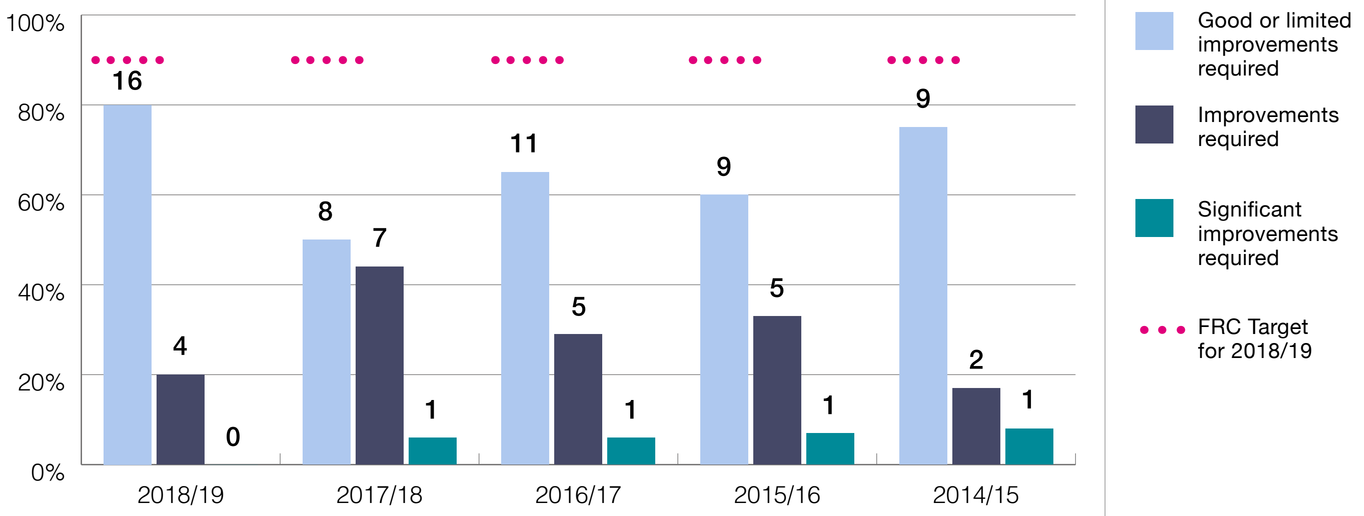
We also paid particular attention to the following areas of focus: changes in auditor appointments; audit of fair value investments (including goodwill impairment); the use of auditor's experts and specialists; and the audit of controls.

Our assessment of the quality of audits reviewed

KPMG



FTSE 350



Changes to the proportion of audits falling within each category reflect a wide range of factors, including the size, complexity and risk of the audits selected for review and the scope of individual reviews. Our selections, which are primarily risk-focused, are also informed by the priority sectors and areas of focus referred to above. For these reasons, and given the sample sizes involved, changes from one year to the next cannot, on their own, be relied upon to provide a complete picture of a firm's performance and are not necessarily indicative of any overall change in audit quality at the firm.

Any inspection cycle with audits requiring more than limited improvements is a cause for concern and indicates the need for a firm to take action to achieve the necessary improvements.

1 Overview

The FRC set a target for the firms that at least 90% of FTSE 350 audits should be assessed as requiring no more than limited improvements by the end of the 2018/19 inspection cycle. Regrettably, no firm inspected this year achieved the target.

As a result, we will, for 2019/20:

- Continue to measure firms' audit quality against the 90% FTSE 350 target and expect all firms to meet that target.
- Extend the 90% target to all other audits within the scope of our inspection.

Stakeholders rightly demand high quality work on all audits and they would expect, we believe, that all audits subject to our review should require no more than limited improvements. We will therefore, for 2020/21 onwards, set a new target for audit firms that 100% of audits should require no more than limited improvements.

All the firms reviewed have performed root cause analysis and identified a number of themes relating to why the audits we inspected did not always meet the required standard and why certain findings recur over a number of years. These themes, across the firms inspected, include insufficient scepticism and weaknesses in project management or resourcing. In addition, the analysis also highlighted inconsistent execution of firms' audit methodologies and quality control procedures. Firms' actions should be targeted and responsive to the findings from their root cause analysis to achieve the required improvements in audit quality.

We will continue to take robust action for all reviews assessed as requiring improvements or significant improvements. To date, for the past two inspection cycles, we have referred 16 audits, across all firms inspected, to the Case Examiner for consideration of further enforcement action. In these cases, we further scrutinise the root cause analysis undertaken by the firm and the actions taken by the firm in response to our findings and consider what additional action we can take to ensure audit quality.

Key findings for KPMG

We assessed 76% of the firm's audits that we reviewed as requiring no more than limited improvements, compared with 61% in 2017/18. Of the FTSE 350 audits we reviewed this year, we assessed 80% as achieving this standard compared with 50% in 2017/18. While the results have shown an improvement from last year, this was from a low base and below our target for FTSE 350 audits. The firm therefore still has more to do to reach a consistently acceptable standard and ensure that the improvement is sustainable.

Our key individual review findings related principally to the need to:

- Improve the quality of the audit of the valuation of financial instruments in financial services entities.
- Strengthen the audit of loan loss provisions in financial services entities.
- Improve the consideration and challenge of cash flow forecast assumptions in relation to the impairment of goodwill.
- Improve the consideration and challenge of management's estimation of provisions.

We had no significant findings arising from our firm-wide work on internal quality monitoring, engagement quality control reviews and independence and ethics.

Given our key individual review findings noted above, however, this would indicate that the firm's quality control procedures have not been sufficiently effective to achieve the necessary improvement in audit quality.

Further details of our key findings are given in section 2, together with the firm's actions to address them.

Audit Quality Plan

In response to significant concerns over audit quality, as set out in our previous report, KPMG started to implement its Audit Quality Plan ("the plan") at the end of 2017. We have reviewed this plan in detail as part of this year's inspection. We consider that the actions taken to date demonstrate the firm's commitment to improving audit quality and we have seen improvements in a number of areas in which we identified key findings last year. However, these actions are part of a longer-term plan which needs to be sustained by the firm.

While actions have been taken in relation to our key findings during 2018, we require the plan to focus more on improving the quality of financial services audits and the robust challenge of management going forward. We will monitor whether the plan remains sufficient to achieve the necessary improvements to audit quality.

Further details of the plan are given in section 3, together with our key findings, good practices and the firm's response.

Good practice identified and developments in the year

We identified examples of good practice in the course of our work, including group audits and the audit of going concern. These, together with firm developments in the year, are set out in section 4.

Root cause analysis

Thorough and robust root cause analysis ("RCA") is necessary to enable firms to develop effective action plans which are likely to result in improvements in audit quality being achieved.

The firm has performed RCA in respect of our key findings and considered the outcome in developing the actions included in this report. We will continue to assess the firm's RCA process and encourage all firms to develop their RCA techniques further.

Given that no firm this year has met the FTSE 350 target, firms need to re-appraise whether their RCA accurately identifies the causes of our inspection findings and whether their actions are properly linked to those causes. In particular, the firms should increase their focus on systemic issues behind the findings as well as the findings on each individual audit.

Firm's overall response and actions:

Although we have not achieved the 90% target for FTSE 350 audits, the investment in our audit quality transformation plan which was launched in October 2017, and the commitment of our audit teams have been significant factors in the improvement in our inspection results. We recognise that more is needed to embed fully our audit quality transformation plan and to consistently achieve the level of quality to which we aspire.

It is notable that the actions taken contributed to improvements in two areas of key findings that required action in last year's report - the conduct of group audits and the audit of long term contracts – both of which have been highlighted as good practices in this report.

We are committed to making the financial investments and other changes necessary to sustain the improvements achieved, including ensuring that we have sufficient resources to deliver our plan and to embed a culture of continuous improvement in audit quality.

Our strategy, which has been informed by root cause analysis, is to further increase standardisation of our audit approach, increase our in-flight review team, the Second Line of Defence (2LoD), support and coach our teams, enhance our tools and materials and increase consultation.

Importantly, as part of our programme to implement the International Standard on Quality Management 1, we have initiated a global programme to review and enhance our risk and control framework as it affects audit quality.

Based on our multi-year audit quality transformation plan and informed by root cause analysis, we are now focussing our plan for the next year on activities to help embed and sustain the changes introduced since the end of 2017. The core theme from our root cause analysis is that whilst audit teams are engaged with our transformation plan, it takes support and coaching to ensure that these actions are fully embedded and become part of business as usual audit delivery on every audit. The actions we are taking include:

- increasing the number of people in our 2LoD, particularly in Financial Services;

- reinforcing audit quality on specific topics including the audit of estimates, through in-depth practical training at our 2019 KPMG Audit University;
- providing our people with the tools to coach and support each other using external experts including a psychologist;
- extending the depth and timeliness of planning and risk assessment on all audits and building on the enhancements made during 2018;
- equipping teams with the project management skills necessary to ensure that these improvement actions become fully and sustainably embedded in business as usual; and
- continuing to refine our requirements to support consistent execution.

KPMG International is significantly enhancing our global audit methodology and is creating a new automated audit workflow which is in limited deployment in 2019 and full deployment is planned from 2020. This will embed the changes already made as part of our audit quality transformation plan into our audit work flow.

We believe we have laid the foundations for sustainable improvements in audit quality with the actions taken. These are reinforced by the changes we have made to the governance of our audit practice described in last year's report, and the changes to performance assessment and reward processes, in which audit quality is the overriding determinant of an auditor's performance, and therefore of their reward.

We will continue to re-assess our governance and our audit quality plan taking account of the recent external reviews impacting the profession.

Our plan is on track and we are fully committed to completing it, so that we can achieve consistently high quality audit delivery.

2 Key findings requiring action and the firm's response

We set out below the key areas where we believe improvements are required to enhance audit quality and, where relevant, safeguard auditor independence (other than those detailed in section 3). We asked the firm to provide a response setting out the actions it has taken or will be taking in each of these areas.

Improve the quality of the audit of the valuation of financial instruments in financial services entities

The valuation of financial instruments can involve significant management judgement and estimation uncertainty. Fair values are often calculated based on complex management models which require a number of assumptions and other inputs. Auditors should assess the risks inherent in the different portfolios and design and perform audit procedures responsive to those risks.

Findings

The audit of fair value instruments was an area of focus in our inspections this year and we reviewed it on all of the financial services entities audits selected for review. We identified weaknesses in aspects of the audit procedures performed to test fair values (or the evidence thereof) in most of these audits, including the following on one or more audits:

- Insufficient testing of management's methodologies and assumptions relating to certain valuation models or portfolios, or insufficient evidence of the testing (for example, weaknesses in the independent pricing of financial instruments).
- Insufficient evidence of the nature and extent of the testing of the operating effectiveness of certain key controls, in particular the validation of valuation models.
- Insufficient precision in the risk assessment and scoping of audit procedures for individual portfolios, leading to insufficient justification for the selection of sample populations subject to testing.
- Insufficient assessment of the reliability and reasonableness of fund manager statements used in the valuation of certain private equity and other investments.

Firm's actions:

We will continue to refine our approach, which was developed reflecting root cause analysis findings. This has led us to focus on the support provided to teams in terms of both structured work programmes and greater integration of our specialist groups, as well as the size of the Financial Services 2LoD review team.

In the second half of 2018 after the audits in this review cycle were concluded, we released a suite of standardised working papers which will help address the areas highlighted in this report, specifically:

- Risk Assessment framework: the key output is a framework which categorises financial instrument positions according to risk enabling the overall audit approach to be tailored for each risk population appropriately.
- What Could Go Wrong ("WCGW") risks: this is a library of WCGW risks for engagement teams to use in their audit, as the core operating principles for the valuation of financial instruments held at fair value are largely consistent. In addition, we have developed a consistent approach to testing the controls over fair value of financial instruments.
- Valuation model validation controls: this is guidance on how to assess the control elements within the validation process including consideration as to where management are exercising judgement and to how this is to be tested.
- Third party information: we will ensure that the procedures now routinely and effectively performed in our audits of pension scheme assets are replicated in our audits of financial instruments more generally.

Other activities which are underway in 2019 that will drive improvement in this area include improving the project management and coaching skills of our teams.

Strengthen the audit of loan loss provisions in financial services entities

Loan loss provisioning involves significant management judgement and estimation uncertainty. Provisions for loans are calculated either on a specific basis, when individually impaired, or on a collective basis, usually based on management models. Auditors should perform sufficient procedures to corroborate and challenge the models' key inputs and assumptions, in order to support their conclusions.

Findings

We reviewed the audit of loan loss provisions for those financial services entities where the provisions were identified as a significant risk. We identified issues in both the testing and challenge of models and assumptions for collective provisions and the assessment of specific loans, including the following on one or more audits:

- Insufficient testing of certain key assumptions used in provisioning models and the completeness and accuracy of data supporting those assumptions, or insufficient evidence of the testing.
- Insufficient evidence obtained to support the audit team's evaluation of the recoverability of some of the individual specific loans selected for testing.
- Weaknesses in the testing of certain IT application or management review controls related to the calculation of loan loss provisions.
- Insufficient evidence supporting the audit team's consideration of the classification and measurement of embedded derivatives included in the loan arrangements.
- Weakness in the quality control procedures at an engagement level, including insufficient evidence that certain audit procedures had been performed by the date of the auditor's report.

Firm's actions:

Our audit approach to loan loss reserves was developed significantly in response to the implementation of IFRS 9 which for many financial services entities was first effective for 2018 year ends. This also took account of root cause findings relating to the need for a more structured audit approach in this area. In addition to the changes already introduced, including the increase in our 2LoD team and expanding the remit of our risk panels, the following specific actions will be taken in respect of the findings above:

- Tailor our estimates workpaper for the audit of loan loss reserves, the assumptions thereon and the completeness and accuracy of data supporting those assumptions.
- Continue to refine our mandatory credit review workpaper, which was made mandatory in 2018.
- Provide additional training to all Financial Services qualified staff on the audit of loan loss reserves, which will include testing approaches to IT applications and management review controls applicable to loan loss reserves.
- Provide guidance on the key issues associated with equity release mortgages including mandatory consultation where the impact could be material.
- Continue to expand the size and remit of 2LoD to reinforce our firm quality control procedures and continue to reinforce the importance of the nature and timing of file completion procedures.

We have developed a program of stakeholder engagement with standard setters, financial service regulators and audit regulators to understand how well our IFRS 9 expected credit loss audit methodology achieved the outcomes desired by all parties. We will continue to refine our approach with the learnings from this process, and the IAASB project update expected in Q3 of 2019 on the audit of IFRS 9.

Improve the consideration and challenge of cash flow forecast assumptions in relation to the impairment of goodwill

The assessment of potential impairment in goodwill includes the estimation of future cash flows, which can require significant judgement and potential management bias. Auditors should corroborate and challenge these assumptions to support their conclusions over the extent of impairment.

Findings

We reviewed the audit of impairment on almost all audits that we inspected where this was identified as a significant risk. While the audit work in this area was often performed to an acceptable standard, on two of these audits there was insufficient consideration and challenge of management's short-term cash flow forecasts used in the impairment models, including:

- On one of these audits, there was insufficient corroboration and challenge of management adjustments to increase the estimated cash flow forecasts, partly due to an expectation that recently declining profitability would return to historical levels and growth rates.
- On another audit, there was insufficient evidence that the growth assumptions used in the impairment assessments were consistent with those modelled for individual businesses and contracts. There was also insufficient evidence to support certain other assumptions (not covered by these models) such as the achievability of estimated cost savings.

Firm's actions:

Although we have made good progress in the area of goodwill testing we recognise that our audits need to be delivered to a consistently high standard. Our root cause analysis, which drew conclusions from audits with both positive and adverse findings, has informed these actions.

We have refreshed our work papers in this area to ensure they are responsive to the specific scenarios reflected in these findings, in particular around evidence to corroborate management assumptions. We have already shared the findings of these reviews with the audit practice. Our 2LoD teams will reflect these findings in their review procedures. The partners leading our challenge risk panel process also now consider these areas.

We have started to deploy restructuring specialists on teams where goodwill impairment considerations rely more heavily on cost saving initiatives – this will continue. We have also launched a coaching programme to support individuals and teams as they develop their experience of auditing more complex areas such as this.

Finally, we will provide good practice examples for teams to use to sense check their audit approach.

Improve the consideration and challenge of management's estimation of provisions

Provisions are based on management estimates and can involve significant judgement. Audit teams should apply an appropriate level of challenge, together with sufficient audit work, to evaluate those assumptions and evidence the work performed.

Findings

We identified issues in relation to different types of provisions on the audits we reviewed. In addition to the audit of loan loss provisions, set out separately above, these included findings relating to the following types of provision:

- Insurance receivables: insufficient corroboration and challenge of management assumptions and testing of claim data supporting the provisions for impairment of accounts receivable (one audit).
- Insurance contract liabilities: insufficient evidence of the work performed by the firm's actuaries, including the justification of the methodology and assumptions used in the valuation of the insurance contract liabilities (one audit).
- Litigation and claim provisions: insufficient evidence relating to the assessment of certain estimates for litigation outcomes or claims provisions (three audits).

Firm's actions:

The findings in this area cover a range of topics. In 2018 we introduced new requirements in relation to the audit of estimates that are relevant to several of these areas. We have provided materials to audit teams to help them address situations where estimates are highly judgemental and the range of outcomes potentially very broad. We have developed initial materials to support audit teams in the area of complex litigation and claims where access to audit evidence may be impacted by legal privilege issues.

Our root cause analysis, which indicated clearer guidance for audit teams in certain specific circumstances was needed, has informed these actions. We have a significant focus on the audit of management estimates in our 2019 KPMG Audit University and further guidance is being developed to reflect emerging market practice from legal advisors in relation to addressing the issue of legal privilege.

In addition to updated specialist support training already released, we will provide further clarity and coaching around the integration of the work of KPMG insurance specialists, including insurance actuaries specifically into our overall audit approach to address areas of uncertainty.

3 Audit Quality Plan

Background

KPMG commenced implementation of its detailed Audit Quality Plan at the end of 2017, with the objective of achieving greater consistency in audit quality. We have expanded the scope of our inspection work to review key aspects of the plan, following the significant concerns about audit quality set out in our 2018 report.

The plan has included a number of different initiatives across the following areas:

- Leadership and governance
- Values and behaviours
- Business model
- Risk management
- Audit quality

KPMG has implemented the plan on a phased basis to ensure it is manageable and achievable for both the firm and audit teams. The initial phase (late 2017 to early 2018) focused primarily on immediate actions to improve consistency in audit quality; the second phase (during 2018) aimed to strengthen governance, audit training and resources, with actions to improve further audit consistency. A third phase takes place in 2019 and 2020, to build on these initiatives, focusing more on audit team behaviours and the roll out of a new audit system.

The key initiatives which we focused on during our review of the plan, and their timing of implementation in relation to audit year-ends, can be summarised as follows:

Started to be implemented before December 2017 year-ends (those audits reviewed in our current inspection cycle)

- Standardisation topics – mandated audit programmes (with guidance), initially covering ten topics, including impairment of assets and group audits, with the objective of achieving greater consistency in audit quality. This was started towards the end of 2017.
- Risk panels – senior audit partners reviewing the risk assessment and audit approach on higher risk audits (focused on business risks). This was started in January 2018, with over 100 panels held in 2018.
- Second line of defence ("2LoD") – independent central review and support of audit teams during the course of the audit (before the opinion is signed). Started in early 2017.

Implemented after December 2017 year-ends (largely those audits to be inspected in our next inspection cycle)

- Audit Quality Committee – oversees, on behalf of the Board, all relevant matters pertaining to audit quality, including the implementation of the plan, and includes executive and non-executive members. It had its first meeting in March 2018.

- KPMG Audit University - a three-day course for partners and senior staff, with 2,900 attendees in 2018, covering a number of key audit areas, for example professional judgement.

- Increased resources – initiatives to create more audit resources, including increased recruitment, reviewing partner portfolios and exiting certain audits.

- Additional standardisation topics released, including the audit of revenue and management estimates.

- More 2LoD reviews using more senior personnel and increased risk panel resources.

Being implemented at the time of our review (therefore not yet reviewed)

- Coaching, project management and audit metrics monitoring – improved processes, focused on audit team behaviours.

- Centres of Excellence – establishing centres in specialist areas, starting with the audit of pension balances.

- Global audit systems – implementation of updated methodology and systems, which is planned to impact December 2020 year end audits onwards.

Key findings

KPMG's audit leadership has demonstrated its commitment to improving audit quality through the way it has implemented the plan to date. As noted in section 1, however, the firm still has more to do to reach a consistently acceptable standard and ensure that improvement is sustainable.

Our main findings are set out below and have been communicated to the audit leadership during the year so that they could take actions to further improve the related processes:

- Timing of actions – only certain actions, as outlined above, impacted the audits we reviewed in 2018/19 (largely December 2017 year-ends). In addition, given when the actions were implemented, they could not have been fully effective (for example, risk panels and 2LoD reviews were often held at the end of those audits, rather than at the planning stage, and additional guidance on "standardisation topics" were introduced in the later stages of those audits).

- Scoping of actions – due to resource constraints within the 2LoD team at the time of the December 2017 year-end audits, this process did not cover all of the firm's FTSE 350 audits (60% at that stage, which has increased in 2018). In addition, the standardisation topics (initially ten) did not cover some key areas, including the audit of revenue and management estimates (issued in 2018); the audit leadership did not believe that these other topics could be implemented in time for 2017 year-ends.

- Financial services audits – largely due to resourcing issues, 2LoD had a limited impact on financial services audits with December 2017 year-ends. In addition, the central standardisation programme did not generally cover financial services specific topics (such as derivatives) and the loan loss topic wasn't mandated. While the financial services practice has introduced and mandated these in 2018, they have not been subject to the same level of central oversight as the other standardisation topics.

- Seniority of 2LoD reviewer/extent of coaching – at the time of our review, the 2LoD team largely comprised managers and senior managers, with no partners. In addition, based on our discussion with audit teams, the 2LoD members were more focused on reviewing audit outputs than coaching the audit teams.

- Consistency of standardisation topics – while certain guidance and templates have been user-friendly, based on our discussions with audit teams, others were felt to be overly detailed (in particular for goodwill impairment).

- Monitoring of actions outside the Audit Quality Plan – the plan has evolved during 2018, with new topics introduced and others moving outside of the plan and monitored by the audit leadership (i.e. "business as usual"). While the Audit Quality Committee has overseen initiatives within the plan, some of those moving to "business as usual" have been overseen by the audit leadership, with less visibility and oversight by the Audit Quality Committee.

- Assessing effectiveness of actions – while the firm has regularly monitored timely implementation of actions, there has been limited formal consideration by the firm (including the Audit Quality Committee) of their overall effectiveness.

- Actions not yet implemented – as explained in the background section, the plan was phased, with the initial actions less focused on the working practices of audit teams (such as coaching and project management). While some 2018 actions, such as the KPMG Audit University, will impact audit team working practices, others (set out in the background) had not been implemented at the time of our review. The plan is due to continue into at least 2020.

Firm's actions:

The extent of change we have introduced in the last 18 months has been considerable. We made a conscious decision to focus first on standardising our approach to those topics of greatest significance, and those which could be implemented quickly to impact December 2017 year ends. We are pleased to see the benefits arising from those that were implemented first and that some of these have been called out as areas of good practice in inspections.

During 2018, informed by our root cause analysis findings, we issued further standardised procedures for over 20 topics, including the audit of revenue and management estimates and judgements. We continue to review and refine both these and the topics issued in 2017 in order to ensure they are both robust and easy for teams to implement. We introduced an annual three day face to face training programme, the KPMG Audit University, in order to create a better understanding of the importance of audit and expectations of our auditors and create greater team cohesion through joint learning. Creating a positive, supportive environment to focus on audit quality is a key element of our transformation plan.

We have increased the seniority of the 2LoD in-flight review team and continued to expand and broaden its remit to build on its initial successful impact. We have more closely aligned the 2LoD with the risk panel process to ensure the challenge in our risk panel process and the related follow up are integrated and aligned with the 2LoD process. Looking ahead we are focusing on coaching in the audit and our 2LoD teams have an important role to play in this respect.

We have provided more detail on our financial services audit response in the individual topic areas but we recognise that, due to the complexity of many of the underlying audits, the improvement actions taken last year more quickly impacted outcomes in our non-financial services audits. As a result, we have increased the level of resource and focus on areas impacting financial services audit quality.

As noted by the AQR, our focus has been on the development and deployment of the tools needed by our teams. We have been monitoring in real time the use and effectiveness of the actions taken through targeted reviews, 2LoD feedback, the analysis of implementation queries and our internal quality reviews.

In summary, our audit quality actions are progressing to plan and are making the expected positive impact but we are conscious that we need to maintain the momentum achieved in order to sustainably embed our improvement actions.

Good practice

We draw attention to the following good practices identified as part of our review of the Audit Quality Plan:

- Audit Quality Committee – as well as members of the Audit Executive, the Committee comprises firm personnel outside audit and non-executives, with the Chair now outside the audit practice. This enables a level of challenge of the appropriateness of the actions to improve audit quality which we observed by attending two meetings in 2018. The Committee has, for example, influenced decisions to improve resources in the audit practice and central functions.

- Standardisation topics – the audit guidance and templates for certain topics were comprehensive and user-friendly. For example, they appear to have contributed to the improvement in quality of work in relation to group audit considerations.

- Risk panels – the review of risks by a panel of partners on higher risk audits has introduced an additional level of challenge relating to audit teams' risk assessment and responses to those risks.

- 2LoD monitoring of findings – the team reports to the Audit Executive and Audit Quality Committee on common themes identified in its reviews, providing important insights into audit quality.

- KPMG Audit University – the new-style training in 2018 enhanced the level of training for audit personnel and has provided more face-to-face training than in the past.

4 Good practice examples and developments in the year

Good practice

We set out below the key areas where we noted good practice, either in audit work on individual engagements or firm-wide procedures.

Individual audit reviews

Good practice examples identified included the following:

Going concern

- High quality of audit procedures performed over the working capital model used in a going concern assessment and related communications to the Audit Committee.
- Robustness of challenge in relation to a going concern assessment, including requests to management to delay the reporting timetable.

Group audits

- Extent and quality of evidencing of the group audit team's involvement and review of work performed by component audit teams.
- Well-evidenced risk assessment and scoping of procedures at a component level.

Long term contracts

- Co-ordination and oversight of work performed by component teams, including the application of tailored methodologies for selection and testing of individual contracts.
- Use of an auditor's expert to assess costs on a significant judgemental contract.

Firm-wide procedures:

- Several aspects of the Audit Quality Plan (refer to section 3).

Developments in the year

Following actions from the firm, we have seen an improvement in relation to most of the key findings highlighted in last year's report.

As part of the firm's Audit Quality Plan, enhancements have been made to the firm's policies and procedures during the year in a number of areas. A summary of the plan, together with our principal findings is set out in section 3 of this report.

We note the co-operation and assistance received from the partners and staff of the firm in the conduct of our 2018/19 inspection.

Audit Quality Review

FRC Audit and Actuarial Regulation Division

July 2019

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