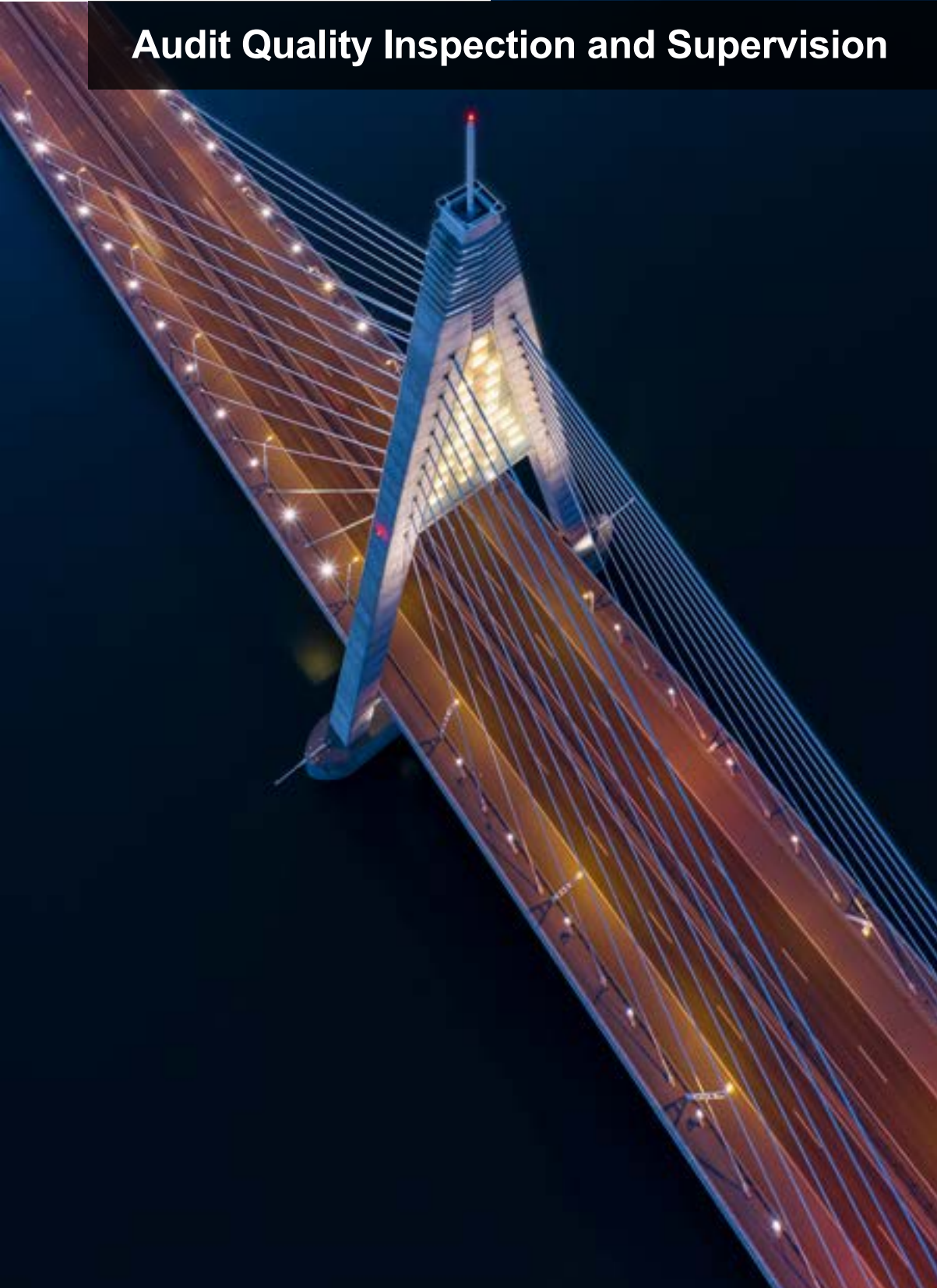




Financial Reporting Council

Deloitte LLP

Audit Quality Inspection and Supervision



July 2021

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This report sets out the FRC's findings on key matters relevant to audit quality at Deloitte LLP (Deloitte or the firm). It is based on inspection and supervision work undertaken in our 2020/21 cycle, primarily our review of a sample of individual audits and our assessment of elements of the firm's systems of quality control.

The FRC's focus is on the audit of public interest entities (PIEs¹). Our selection of individual audits and the areas within those audits for inspection continues to be risk-based focusing, for example, on entities which: are in a high-risk sector; are experiencing financial difficulties; have material account balances with high estimation uncertainty; or, where the auditor has identified governance or internal control weaknesses. The majority of individual audits that we inspect are of PIEs but we also inspect a small number of non-PIE audits on a risk-based basis.

Higher-risk audits are inherently more challenging as they will require audit teams to assess and conclude on complex and often judgemental issues, for example in relation to future cash flows underpinning assessments of impairment and going concern. Rigorous challenge of management and the application of professional scepticism are especially important in such audits.

Our increasing focus on higher risk audits means that our inspection findings may not be representative of audit quality across a firm's entire portfolio of audits or on a year-by-year basis. Our inspection findings cannot therefore be taken as a balanced scorecard of the overall quality of the firm's audit work. However, our forward looking supervision work now provides us with a holistic picture of the firm's approach to audit quality and the future development of its audit quality improvement initiatives.

As well as risk-based selections, we aim to review all FTSE 350 audits periodically.

To provide a more holistic assessment of audit quality, the report also includes reference to other measures of quality at the firm. The Quality Assurance Department (QAD) of the Institute of Chartered Accountants in England and Wales (ICAEW) inspects a sample of the firm's non-PIE audits, the results of which are summarised on page 8.

The firm also conducts internal quality reviews. A summary of the firm's internal quality review results is included at Appendix 1, together with the actions that the firm is taking in response.

At Appendix 2 are further details of our objectives and approach to audit supervision.

¹ Public interest entity – in the UK, PIEs are defined in the Companies Act 2006 (Section 494A) as: - Entities with a full listing (debt or equity) on the London Stock Exchange (Formally "An issuer whose transferable securities are admitted to trading on a regulated market". In the UK, "issuer" and "regulated market" have the same meaning as in Part 6 of the Financial Services and Markets Act 2000); - Credit institutions (UK banks and building societies, and any other UK credit institutions authorised by the Bank of England); - Insurance undertakings authorised by the Bank of England and required to comply with the Solvency II Directive.

1 Overview

Commentary on our inspection work at the largest audit firms

We completed more audit inspections at the largest seven firms in 2020/21 (103) than in 2019/20 (88). Our overall inspection findings are similar to last year, with 71% of audits (73 out of 103 inspections) requiring no more than limited improvements compared to 67% last year (59 out of 88 inspections).

The number of audits that we have assessed as requiring improvements remains unacceptably high. This year the results varied more between firms and we found inconsistencies, with good practice in some audits but deficiencies in the same areas in other audits at the same firm.

The most common key findings in our public reports are in relation to revenue, impairment of assets and group audit oversight. These are recurring issues but we also identified good practice in these areas in some audits.

We also identified good practice during our 2020/21 thematic review of the audit of going concern, where we found that firms had responded positively to the increased risk arising from Covid-19, by enhancing their procedures in this area².

Four of the largest firms (Deloitte, EY, Grant Thornton and PwC) had a year-on-year improvement in their overall inspection results, with around 80% or more of audits requiring no more than limited improvements. While this is encouraging, these improved results still fall short of our expectations.

Overall inspection results at KPMG did not improve and it is unacceptable that, for the third year running, we found that improvements were required to KPMG's audits of banks and similar entities. In addition, our firm-wide work on KPMG's IFRS 9 procedures and guidance identified that further improvements are required to provide a stronger basis for KPMG's banking audit teams to deliver high quality audits in this area. KPMG has already invested significantly in its banking audit practice and considers that, based on steps it has already taken, it will be able to demonstrate improvements in 2020 year-end audits. In response to our findings this year, the firm's senior leadership has committed to make the further changes necessary to improve audit quality in time for 2021 year-end audits. We will monitor these closely to assess on a timely basis the extent to which they address our findings.

This year, we increased the sample of audits we selected for review at BDO and Mazars, given their growth, with a focus on complex audits. Five of the nine audits that we reviewed at BDO and three of the seven audits that we reviewed at Mazars needed more than limited improvements. These firms have grown the size of their PIE audit practices and have plans to grow further, which will increase competition and choice in the market. Our engagement indicates that these firm are genuinely committed to improving audit quality but they must put in place the necessary building blocks for the consistent execution of high quality audits as they grow.

71%

Overall, the number of inspections requiring no more than limited improvements fell short of our expectations.



This year, results varied more between firms and we found inconsistencies, with good practice in some audits but deficiencies in the same areas in other audits at the same firm.

² <https://www.frc.org.uk/getattachment/953261bc-b4cb-44fa-8566-868be0ff48dc/FRC-going-concern-review-letter.pdf>; and [https://www.frc.org.uk/getattachment/c1ec4c8f-0eb3-44b9-a4c7-5fe5e4c0e0f1/FRC-going-concern-review-letter-\(phase-2\).pdf](https://www.frc.org.uk/getattachment/c1ec4c8f-0eb3-44b9-a4c7-5fe5e4c0e0f1/FRC-going-concern-review-letter-(phase-2).pdf).

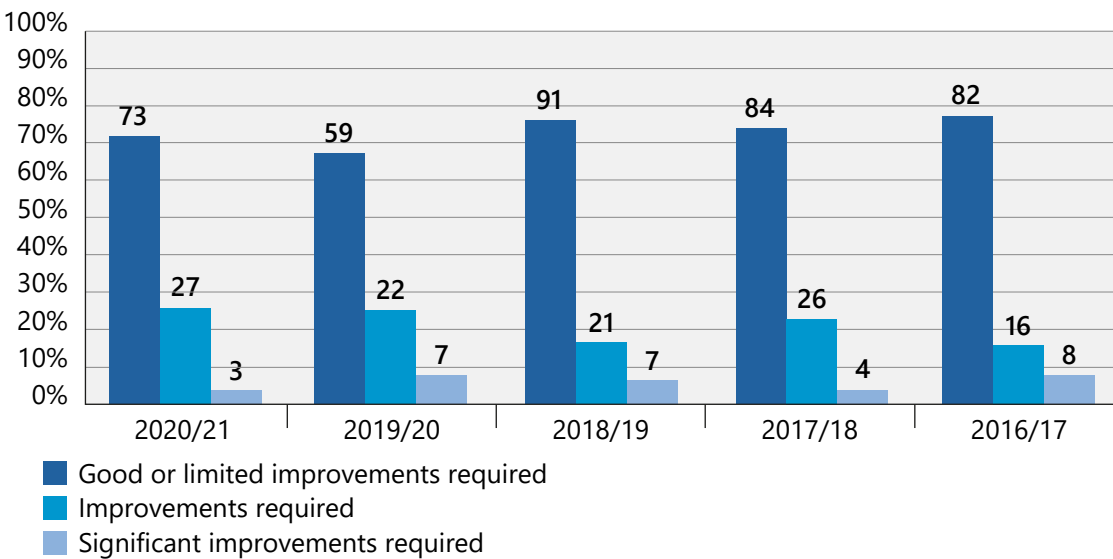
Central to achieving consistent audit quality is a healthy culture within the audit practice that encourages challenge and professional scepticism, as we set out in our letter to Heads of Audit in [December 2020](#). We have a major project underway to examine audit culture, including an international conference held in June this year on the subject. Operational separation of audit practices from the rest of the firm should help the largest firms to focus on developing an appropriate audit culture.

Our supervision teams³ are increasing the range of pro-active and forward-looking work they are carrying out with the largest seven firms in areas such as audit quality plans, root cause analysis, quality control procedures and audit quality indicators with a focus on how firms are responding to recurring findings. We report privately to firms on our findings in these areas, in order to share good practice. In 2021/22 we will continue to focus our inspections on KPMG banking audits and we will increase audit inspections at BDO and Mazars. Our 2021/22 inspections will also focus on and take into account the impact of Covid-19 on audits.



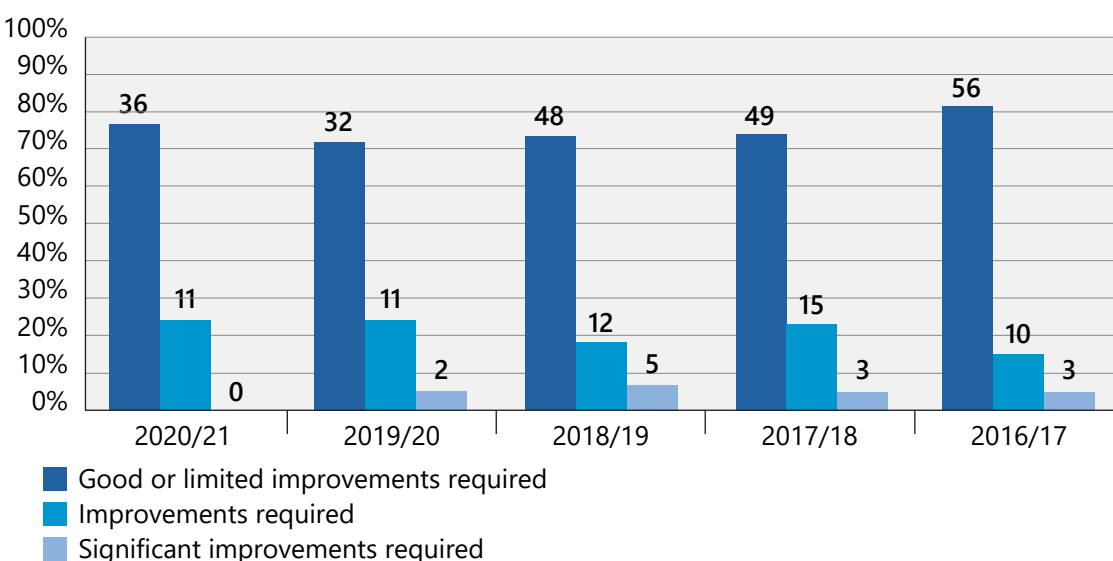
Our supervision teams are increasing the range of pro-active and forward-looking work.

All reviews



In 2021/22 we will continue to focus our inspections on KPMG banking audits and we will increase audit inspections at BDO and Mazars.

FTSE 350



³ Our approach to supervision is set out in the March 2021 publication, <https://www.frc.org.uk/getattachment/db4ef2e0-72f6-4449-bda0-c8679137d1b1/FRC-Approach-to-Audit-Supervision-FINAL.pdf>

Deloitte overall assessment

We reviewed 19⁴ individual audits this year and assessed 15 (79%) as requiring no more than limited improvements. Of the 11 FTSE 350 audits we reviewed this year, we assessed eight (73%) as achieving this standard.

The firm has taken steps to address the key findings in our 2019/20 public report, with actions that included increasing the extent of consultations, and enhanced learning, coaching and support programmes. We have identified improvements, for example, in the extent of challenge of management by audit teams in respect of the estimates used for model testing. This was identified as a key finding last year. We also identified good practice in a number of areas of the audits we reviewed (including robust procedures relating to going concern and evidence to support the challenge of management in areas of key judgement) and in the firm-wide procedures (including establishing a centre of excellence focused on credit for banking audits to encourage the consistent application of the firm's methodology and guidance). The findings that contributed most to this year's inspection results related to the evaluation and challenge of management's key assumptions for goodwill assessments and the consistency of group audit teams' oversight of component audits.

Deloitte's Audit Quality Plan (AQP or the plan) incorporates UK specific procedures, while following the format set by the global firm. The firm has recently enhanced the content of its AQP. The updated plan includes key short and medium term quality initiatives and details of their milestones and current status. The plan's progress and achievements are reported to and overseen by the newly established, independent, Audit Governance Board (AGB). The firm would benefit from extending its assessment of audit quality initiatives to cover the overall effectiveness of the AQP. The culture of challenge should continue to be strengthened and more fully embedded into the AQP. The plan is well presented, with a clear link to ISQM ⁵ included for each initiative.

Deloitte's Root Cause Analysis (RCA) processes are well established. The firm has continued to strengthen its team, enhance its processes and has further broadened the coverage and scope of its RCA. The firm's RCA is conducted on an ongoing basis, enabling themes and responses to be promptly identified and developed. Findings are regularly shared with and considered by senior members of the audit practice. Improvements are needed to identify more effective responses for findings that continue to recur (including impairment assessments of goodwill and other assets and revenue testing) albeit we note that the severity of certain findings has reduced.

The firm needs to take specific action to address the root causes of our findings, particularly where these are recurring; in these cases the firm should consider why previous actions did not adequately address the findings raised.

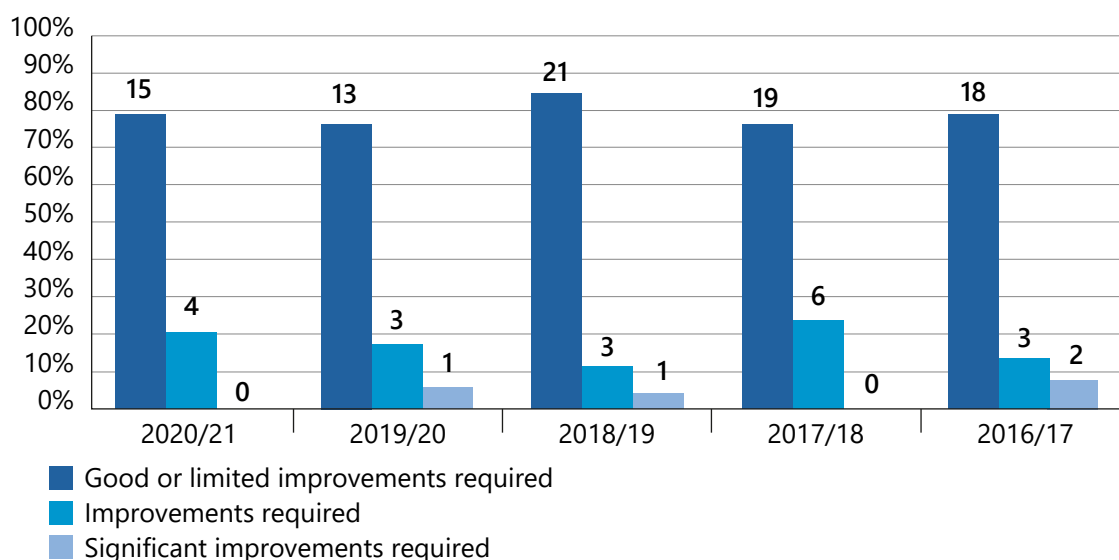
79%

At Deloitte, more of the audits reviewed in the current inspection cycle were assessed as either good or limited improvements required.

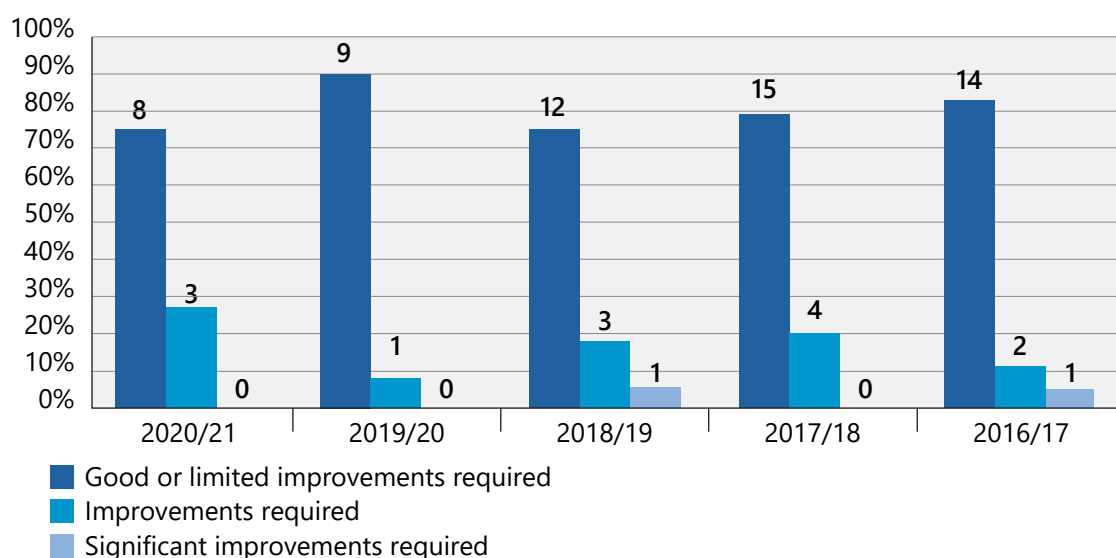
⁴ We reported on 20 audits (12 FTSE 350 audits) in the current inspection year. Following an announcement relating to the financial statements of one of the audits we reviewed, while we highlighted our findings to the firm, we did not determine an overall assessment of the audit work. Accordingly, only 19 audits (11 FTSE 350 audits) are included in the numbers, although the findings for the audit are included in this report where applicable.

⁵ The International Standard on Quality Management (ISQM) UK 1 aims to strengthen firms' systems of quality management and is required to be designed and implemented by 15 December 2022.

Our assessment of the quality of audits reviewed: Deloitte LLP



FTSE 350



The audits inspected in the 2020/21 cycle included above had year ends ranging from 30 June 2019 to 2 May 2020.

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 inspections are also informed by the priority sectors and areas of focus as set out in Appendix 2. 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. We were not provided with access to certain audit working papers for two audits we reviewed on the grounds that they were legally privileged and in both instances the groups declined to waive privilege.

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.



Monitoring review by the Quality Assurance Department of ICAEW

The firm is subject to independent monitoring by ICAEW which undertakes its reviews under delegation from the FRC as the Competent Authority. ICAEW reviews audits outside the FRC's population of retained audits, and accordingly its work covers private companies, smaller AIM listed companies, charities and pension schemes. ICAEW does not undertake work on the firm-wide controls as it places reliance on the work performed by the FRC.

ICAEW reviews are designed to form an overall view of the quality of the audit. ICAEW assesses these audits as 'satisfactory', 'generally acceptable', 'improvement required' or 'significant improvement required'. Audits are selected to cover a broad cross-section of entities audited by the firm and the selection is weighted towards higher-risk and potentially complex audits within the scope of ICAEW review.

ICAEW has completed its 2020 monitoring review and the report summarising the audit review findings, and any follow up action proposed by the firm will be considered by ICAEW's Audit Registration Committee in September 2021.

Summary

Overall, the audit work we reviewed was of a good standard. Of the ten reviews, nine were either satisfactory or generally acceptable and one required improvement. The overall profile of results is a slight improvement on the prior year.

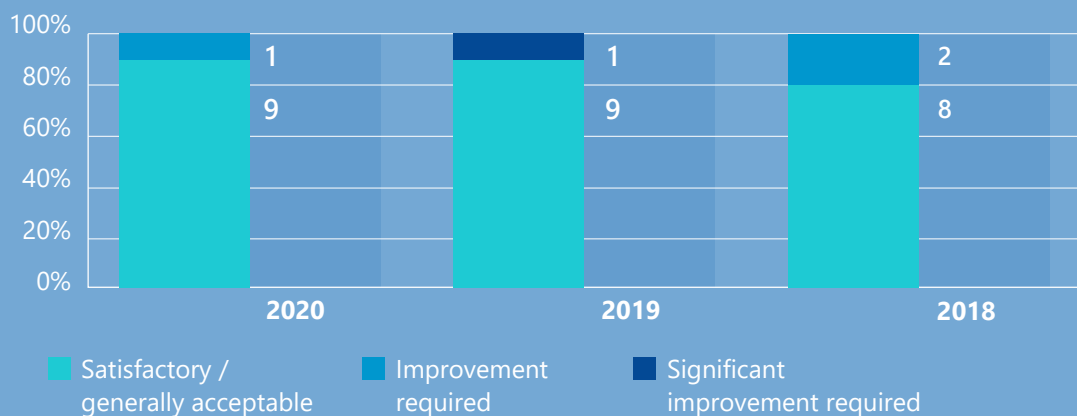
The review requiring improvement was a first year audit. There were documentation weaknesses throughout the audit file, where the audit team placed significant reliance on work done by the auditor of a shared service centre.

Across the sample of audit reviews, ICAEW identified a few relatively isolated matters and a couple of themes relating to substantive analytical review of revenue and using the work of other auditors.

ICAEW also identified and communicated some good practice points.

Results

Results of ICAEW's reviews for the last three years are set out below.



Given the sample size, changes from one year to the next in the proportion of audits falling within each category cannot be relied upon to provide a complete picture of a firm's performance or overall change in audit quality.

90%

Of the ten ICAEW reviews, nine were either satisfactory or generally acceptable.

Review of individual audits

Our key findings related primarily to the need to:

- Improve the evaluation and challenge of management's key assumptions of impairment assessments of goodwill and other assets.
- Enhance the consistency of group audit teams' oversight of component audit teams.
- Strengthen the effectiveness and consistency of the testing of revenue.

Good practice observations



We identified examples of good practice in the audits we reviewed, including the following:

- Robust procedures relating to going concern.
- Evidence of challenge in areas of key judgement.
- Use of bespoke data analytic procedures in the audit of revenue.
- Use of internal experts and specialists.
- Enhanced acceptance and continuance procedures.

Review of firm-wide procedures

This year, our firm-wide work focused primarily on the following areas:

- Audit quality initiatives.
- RCA process.
- Audit methodology and training.

The reason for the focus on audit quality initiatives and RCA is the importance of taking effective action to address recurring inspection findings. On both of these areas we have assessed the firm's progress on the findings set out in last year's public report and re-assessed overall progress.

Audit quality initiatives

Our key findings related primarily to the need to:

- Strengthen the procedures to monitor the effectiveness of the AQP.
- Continue to strengthen the culture of challenge in the audit process and more fully embed audit culture into the plan.

RCA process

Our key finding relates to the need to:

- Improve the effectiveness of addressing recurring findings.

Audit methodology and training

We had no key findings to report.

Good practice observations



We identified examples of good practice in our review of firm-wide areas, including the following:

- **Audit quality initiatives** – Clarity and breadth of the plan and linkage to ISQM 1.
- **RCA process** – Use of a dedicated RCA team and established process; breadth of information used and continual RCA activities.
- **Audit methodology and training** – Establishment of a credit centre of excellence and illustrative audit procedures to support teams performing banking audits.

Firm's overall response and actions



Executing high quality audits remains our number one priority. We are committed to our critical public interest role and continue to embed our culture of quality and excellence into all of our people. This includes using new technology and tools to continue to transform our audit approach. In that context, overall FRC inspection results, showing an improvement since last year from 76% to 79% of all inspections assessed as good or needing limited improvement, reflects the progress we are making. The overall profile of our ICAEW inspections and our internal inspection programme also show a similar overall improvement since last year.

The results for the inspections of FTSE 350 entities fell short of our overall scores reflecting specific findings on those particular audits rather than issues pervasive across other audits. Our objective continues to be for all of our audits to be assessed as good or needing limited improvement and we know we still have work to do in order to meet this standard. Audit quality is the foundation that underpins the ongoing transformation of our audit product and we are committed to driving continuous improvements in quality through investment in our audit processes, policies, quality controls and through leveraging new innovative technologies.

We agree with and accept the FRC's findings on the individual inspections. We note that the FRC has recognised improvements following the actions and programmes for previous years and welcome the good practice points raised, including in respect of impairment and revenue where individual findings continue to occur. Whilst the severity of the findings in these areas have reduced and they are largely relating to circumstances specific to the individual audit or team, further work is required.

We remain committed to continuous quality improvement in these areas and across all other areas of our audits. We have performed independent root cause analysis, not just on every key finding, but across all FRC inspections including those which have been assessed as good or needing limited improvement. As well as identifying actions to be taken in respect of findings, the root cause analysis also assists in identifying good practices and behaviours. Understanding what drives good practice helps us improve the consistency and quality of audits across our entire audit portfolio. The root cause analysis has identified certain causal themes which require action in order to further enhance the evidence of our challenge of management through the audit process. These are often behavioural in nature:

1. Inherent knowledge of the senior team affecting the prioritisation of the review and standback challenge of procedures carried out by the audit team.

Senior members of the team often have a high degree of knowledge of the facts and circumstances of the company, its industry and business model including historic judgements and challenge of management. Further time needs to be spent to ensure that this inherent knowledge held by senior members of the team is fully evidenced and the underlying workpapers are fully reviewed and reflect the challenge given, the nature of the challenge and how the audit work is in line with auditing methodology and standards.

Increased time and review by senior members of the team will ensure that the audit file reflects, on a standback basis, the challenge performed in areas which, due to the team's inherent knowledge, may be considered to involve less judgement compared to other drivers of risk in the balances being audited, including within a significant risk area. This increased focus will also ensure that the audit approach is challenged within the team and explained in the audit file to ensure the appropriate level of testing is performed across all areas of the audit.

2. Sharing of knowledge, insufficient coaching and project management of the audit affecting the quality of review of working papers.

The sharing of experiences and the discussion and debate through the review process is a critical aspect of the coaching and development of our people. Where good practices have been identified through internal or regulatory inspection there are clear indicators of sustained and effective coaching in part through the review process leading to a more thorough evidencing of our challenge on the audit file. This includes sharing knowledge of auditing issues experienced on other audits across a wider population of auditors.

As well as increasing the sharing of knowledge, there is a need for more coaching so that primary reviews are more effective. This requires senior members of the audit team to use their skills and knowledge to develop the rest of the audit team with a focus on 'what good looks like'. Coaching to promote effective project management will also ensure there is adequate time for review and less reliance on certain members of the team.

3. The audit team's response to poor quality information and a deficient control environment at the Company being audited.

The quality of the evidence on our audit files can be impacted by the quality and robustness of the company's control environment, the quality and capability of the company's own financial reporting function, as well as its responsiveness to audit challenge and recommendations from the auditor for improvements. Poor quality information produced by the company can lead to multiple revisions being required following challenge from the audit team. This can cause delays, project management challenges and additional review requirements.

We expect, where appropriate, to increase the communication with management and those charged with governance so that there are clearer expectations set upfront in respect of the quality of information prepared for audit and where necessary, the financial reporting timetable is adjusted as early as possible. This will reduce time pressure on both the company and the audit team and allow for more effective project management of the audit process.

We are pleased that the FRC has highlighted as an area of good practice our system which sees us giving advance notice to companies where we have significant concerns which could impact our ability to continue to act as auditor. We will continue to use this system with communication to company's management and to the Audit Committee where there is a need for specific action and improvement. It is hoped that the current BEIS consultation will contribute to the actions being taken by companies in this regard.

We have considered the results of the root cause analysis in developing our actions in response to the key findings. These are set out in the relevant sections of this report. These actions are part of the overall programme of change that we continue to make to processes and controls across our audit practice.

Overall, we are pleased that there have been no significant findings over our firm wide processes and controls over the last three inspection cycles in the areas subject to rotational review by the FRC. However, we are continually enhancing our processes and controls across our business and such changes will directly or indirectly affect audit quality. The actions we take to address audit quality issues, including responses to regulatory findings are captured within our Audit Quality Plan (AQP). Alongside the specific actions being taken against the root causes detailed above, broader actions captured in the AQP include changes being made in the following areas:

- Governance and Leadership (e.g. governance bodies, business structure post operational separation, ISQM 1 implementation);
- Acceptance and Continuance (e.g. take-on and resignation procedures, portfolio and engagement level risk monitoring, emerging risk identification);
- Resources (e.g. audit methodology changes, audit tools and technology, analytical tools, talent and learning);
- Engagement Performance (e.g. Centres of Excellence, independent review processes, consultations);
- Ethical Matters (e.g. firm and personal independence);
- Continued focus on the culture of challenge; and
- Information and Communication through the business.

Progress in respect of implementation of these actions is monitored by our Audit Quality Board and overseen by the newly established Audit Governance Board comprising four Independent Non Executives.

We have further enhanced our Audit Quality Plan during the year and in particular will continue to focus on assessing the effectiveness of actions taken in relation to recurring findings as well as drawing together the actions being undertaken in respect of the culture of challenge. Ultimately all actions will be captured through the ISQM 1 programme where a global framework is being developed which will serve to further strengthen our system of quality management.

Our supervisory approach

The AFS, AMS and AQR teams in the FRC's Supervision Division work closely together to develop an overall view of the key issues for each firm to improve audit quality. We also collaborate to develop our plans for future supervision work.



The supervisory staff producing our reports

The AFS, AMS and AQR teams comprise over 70 experienced professional and support staff assessing the risks to audit quality and resilience at each firm and the actions needed to address those risks.



Deloitte⁶

RIs
261

Offices
21



15,164
Professional Staff

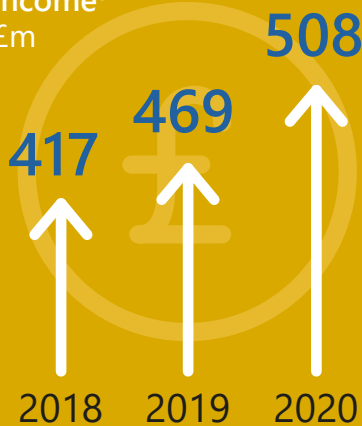
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Audits within the FRC's inspection scope

Inspection Cycle ⁷	FTSE 100 audits	FTSE 250 audits	Total audits in FRC scope
2021-22	21	50	344
2020-21	24	51	392
2019-20	24	61	411

Deloitte

Audit fee
income⁸
£m



Deloitte

Audits inspected
by the FRC⁹



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Local audits¹⁰



6 Source – the ICAEW's 2021 QAD report on the firm.

7 Based on data compiled by the FRC, dated 31 December 2020, 2019 and 2018 respectively and used to select audits for inspection in the relevant inspection cycle.

8 Source – the FRC's 2019, 2020 and 2021 editions of Key Facts and Trends in the Accountancy Profession.

9 Excludes the inspection of local audits.

10 The FRC's inspection of Major Local Audits are published in a separate annual report to be issued later in 2021. The October 2020 report can be found [here](#).

2 Review of individual audits

We set out below the key areas where we believe improvements in audit quality are required. As well as findings on audits assessed as requiring improvements or significant improvements, where applicable, the key findings can include those on individual audits assessed as requiring limited improvements but are considered a key finding in this report due to the extent of occurrence across the audits we inspected. 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 evaluation and challenge of management's key assumptions of impairment assessments of goodwill and other assets

Management's decisions on whether to impair goodwill and other assets relies on them making key assumptions which involve judgement. Changes in key assumptions could result in an impairment. Auditors should sufficiently evaluate and challenge the reasonableness of the key assumptions.

Key findings



Last year we raised a key finding relating to the extent of challenge of cash flow forecasts in relation to the impairment of goodwill and other assets. Given the potential impact on the financial statements we covered the evaluation of goodwill impairment on the majority of audits we reviewed. We continue to identify issues in this area, although have seen some improvement in relation to the severity of the findings. This year we identified findings on six audits, including two assessed as requiring improvements, in relation to the impairment of assets as highlighted below:

- On four of these audits there was insufficient assessment or challenge of certain key assumptions in the cash flow forecasts. On one of the audits requiring improvements, the audit team did not obtain sufficient evidence to assess whether there should have been an impairment of assets, in particular in relation to the impact of certain optimistic assumptions, such as forecast cost reductions. On the other audit requiring improvements, there were insufficient audit procedures to ensure the accuracy of certain reports used in the impairment assessment and insufficient evidence of the evaluation and challenge of management's turnaround plans. On another audit there was insufficient evidence that the historical declines in profitability were only temporary, to support the improvements in the forecasts.
- On two of these audits the audit teams did not sufficiently evidence their consideration and challenge of the period of time used in the assessment of goodwill impairment. One of these related to where a short-term forecast period of 10 years had been used, which was greater than the commonly adopted five-year period and the other related to the assumption that an extension to the useful life of a major asset to support its carrying value was appropriate.
- On two of these audits, there was insufficient consideration given to the treatment and allocation of central assets within the impairment models.

The extent of challenge of forecast assumptions has featured in past inspections. In response the firm has implemented a number of actions, including establishing a centre of excellence focusing on this area, additional training and guidance. The firm should consider the results of its RCA on the recurring findings to determine what additional actions should be taken to address the finding raised.

We continue to identify issues in relation to challenge by audit teams of certain key assumptions in the audit of asset impairment.

Firm's actions:



Auditing management's key assumptions within impairment assessments is one of the most challenging and complex parts of any audit and often involves highly judgemental assumptions. We have continued to see findings become more granular and judgement specific as a result of the actions taken following previous inspections findings. We are committed to continual improvement in this area and we have already taken a number of further actions as a result of the latest FRC findings. The root causes for impairment are consistent with the overall themes identified above.

Impairment on goodwill and other assets is often a key area of focus on the majority of audits. It is a positive step forward that there has been improvement in the severity of findings. Our root cause analysis has indicated that the findings are largely specific in nature to each of the individual audits reviewed. A team's inherent knowledge of an industry or market can sometimes lead to prioritisation of time and focus on specific areas and hence gaps in the way the approach and testing performed are documented on the audit file. This can lead to instances where the level of evidence of challenge across assumptions or inputs into the models has not been consistent or has not been identified in the primary, detailed review.

In respect of actions:

Impairment Centre of Excellence

We continue to see the use of impairment specialists in our Impairment Centre of Excellence ("CoE") as an important element of our approach and our continuing improvement in this area. We have continued to take steps to enhance and develop this, including the following areas where we have made or are making further enhancements in response to the root causes identified:

- We refreshed the structure and oversight of the CoE to establish clear partner leadership and introduced frequent communication touchpoints to share best practice, hot topics and technical updates. Additional training was provided to the CoE specialists which included the sharing of recent inspection findings.
- We performed a risk focused strategic allocation of impairment specialists for a selection of December 2020 audit engagements, taking into account industry knowledge and experience. Going forward we will seek to involve the EQCR partner to determine whether the allocated specialist should have industry knowledge or whether generalist knowledge would provide an enhanced independent challenge to an industry focused engagement team.
- We will update our impairment guidance notes and consultation document to include specific risk criteria which require further discussion with a panel of specialists, including, but not limited to, where the audit team develop their own model or where cashflow forecasts extend beyond a commonly used period.

To further address issues relating to inherent knowledge, risk-related prioritisation, coaching and sharing of knowledge:

- The launch of the Digital Blueprint project management tool will assist teams in prioritising their time across all areas of the audit. This tool supports teams to focus on the activities required at each stage of the audit cycle to ensure that they are prioritised by the appropriate team member at the appropriate time during the audit process.

- We will hold workshops with our partners and directors to bring to life the common causes that have led to FRC findings and to ensure greater consistency in expectations in respect of the expected depth of review.
- We have introduced a new coaching program to support the development of primary reviewing skills and to identify any reviewing skills gaps which need addressing.
- To respond to the poor quality and untimely preparation of information by the company for audit, we expect, where appropriate, to increase the communication with management and those charged with governance so that there are clearer expectations in respect of the quality of information prepared for audit. Where necessary, the financial reporting timetable will also be adjusted.
- We have updated our impairment template memo to reflect the most recent inspection findings and intend to develop this to encourage earlier focus in the audit process on these complex areas.
- We will develop additional training materials on hot topics and areas of regulatory focus, for example, guidance to assist in the challenge of cash flow assumptions and cost reduction initiatives.

We also developed a new template to support teams in auditing accounting estimates in response to the requirements of ISA (UK) 540 revised 'Auditing Accounting Estimates & Related Disclosures'. We plan to complete a post implementation review of the revised standard to determine whether engagement teams require additional guidance in this area.

Enhance the consistency of group audit teams' oversight of component audit teams

The group audit team are responsible for the oversight of the group audit, including work at component level and therefore need to demonstrate sufficient involvement throughout the audit process.

Key findings



For all group audits inspected, we reviewed the level of involvement of the group audit partner and other group audit team members in the direction, supervision and review of the component audit teams. While audit work was performed to a good standard in a number of these audits, on six audits, we identified findings in respect of certain aspects of the group audit team's oversight, including two assessed as requiring improvements, as highlighted below:

- On three of the audits, there were areas of the audit where there was insufficient evidence that the group audit team had adequately assessed the work of the component auditors, including the approach adopted and whether additional procedures were required to obtain sufficient assurance. On two of these audits, this related to a number of key audit areas for significant components. On another audit there was insufficient evidence of the group audit team's evaluation of the procedures performed in relation to subsequent events of a significant component.

We identified findings in respect of certain aspects of the group audit team's oversight of component teams.

- On two of the audits there were findings relating to the consideration of independence and ethical requirements for component audit teams. On one of these, the group audit team did not obtain confirmation from the component audit team of its understanding and compliance with the UK Ethical Standard. On another audit, the group audit team did not adequately consider whether certain individuals on the group audit should have been identified as “other partners or senior staff”. In view of the length of involvement of these individuals, the group audit team should have considered the potential familiarity threat arising and whether the safeguards adequately mitigated the potential risk to independence.
- On two of the audits, there was insufficient evidence of the involvement of the Engagement Quality Control Reviewer (EQCR). On one of these audits, there was insufficient evidence of the EQCR’s review and challenge, for certain areas of significant risk. In the other audit, the EQCR did not discuss matters arising with the key audit partner of a significant component, or clarify why this was not considered necessary, as required by Auditing Standards. While conversations were held between the EQCR and the key audit partner for another significant component (on the same audit), there was insufficient detail of the matters discussed, or the extent of evaluation by the EQCR.

Firm’s actions:



Inherent knowledge of the business can lead to a prioritisation of time by the group engagement team on other areas of the audit. This has on occasion resulted in a focus on the areas that were identified by the audit team as most relevant to the group audit when supervising, directing and reviewing component auditors’ work. This has led to a degree of reliance being placed on procedures performed by component audit teams and a discussion with component teams of their audit procedures instead of a detailed review, evaluation and documentation of those procedures. In some cases, this has led to incomplete evidencing of the extent of supervision and direction of component audit teams’ work.

Our RCA also identified a knowledge gap of certain requirements under Ethical Standards in one group audit team and an overseas component audit team. This led to gaps in the independence considerations evidenced on the audit file.

In response to these findings and the overall focus on inherent knowledge, coaching and sharing of knowledge we have done or plan to do the following:

- We have appointed a partner who, together with a number of experienced directors, will lead a series of coaching workshops where we will walk through and discuss good practice examples (including those noted from external reviews) of how audit teams have undertaken group audits together with examples of where pitfalls have been identified. Those workshops will be attended by engagement teams to ensure a range of audits are covered and that those teams can also take learnings to their other group audits.
- We will also refresh our practice aid to develop a reference point for those good practice examples and learnings from the inspection cycle that will be made available to all audit practitioners. We also intend as part of identifying good practice examples, to share templates that audit teams can use to evidence the communications held throughout the audit process with component audit teams. This will help to demonstrate the required oversight and direction performed by the group audit team by evidencing in detail the interaction / challenge / resolution of issues with component teams.
- We issued a reminder of the EQCR requirements with respect to holding discussions with Key Audit Partners in our January 2021 EQCR briefing which was delivered to all EQCR reviewers.

- We have regularly communicated the FRC findings, including those on group audits to the wider audit practice during the inspection cycle through our National Accounting & Audit digest emails to ensure that audit teams who might be affected by the findings are fully briefed.

Overall, our medium-long term audit transformation strategy is focused on driving a common approach to audit execution globally to promote audit quality, including the continued standardisation of procedures and leveraging leading-edge technologies. We continue to roll out our enhanced audit tools, the Deloitte Way Workflows, to additional areas of the audit. These support a consistent testing approach, based on a guided risk assessment tool. When these workflows are fully implemented, they will ensure that all audit teams perform the same level of work on balances classified at the same risk level and that the work is evidenced and reviewed in a consistent way.

This strategy will further serve to ensure greater global consistency and support our teams in executing a more consistent approach to the oversight of the work performed by component audit teams.

Strengthen the effectiveness and consistency of the testing of revenue

Revenue is a key driver of operating results and a key performance indicator on which investors and other users of the financial statements focus. Audit teams should ensure that they design an approach which is responsive to the identified risks and undertake adequate audit procedures to address the risks.

Key findings



Last year we raised a key finding regarding the effectiveness of substantive analytical review and other testing procedures for revenue. This year, we reviewed the audit of revenue on the majority of audits inspected and had findings on six of them. The findings mainly related to the adequacy of substantive analytical review procedures and controls testing, including one assessed as requiring improvements in relation to the testing of revenue, as highlighted below.

- On three of these audits, we raised findings relating to the performance of substantive analytical review procedures. When relying on such procedures the auditor needs to set an independent expectation of revenue, compare it to recorded revenue and investigate the differences. The findings were in respect of the sufficiency of evidence obtained to support the expectations set by the audit team in relation to pricing or sales volumes. On one of these audits, there was also insufficient follow up and corroboration of certain variances identified between the expectations set and the actual results.
- On four of these audits, we raised findings relating to aspects of controls testing. On one audit, the audit team did not obtain sufficient evidence that a key control, relating to the accuracy of billed revenue, had operated effectively. On two other audits, the audit team did not adequately demonstrate why it was appropriate to rely upon certain key controls. On another audit, the audit team relied upon information used to estimate a significant revenue stream, however, there was insufficient testing of the IT controls relating to the accuracy and integrity of this information.

The effectiveness of the testing of revenue has featured in past inspections, as such, the firm has implemented certain actions, including additional training and the introduction of practice aids. The firm should consider carefully the results of its RCA on the recurring findings in this area to determine what additional action should be taken, in particular in light of the recurring findings year-on-year.

We reviewed the audit of revenue on the majority of audits inspected and had findings on six of them.

Firm's actions:



Revenue is a key audit area and we have been focused on continuous improvement following recent inspection findings and acknowledge that some areas of our work should be further improved.

We have taken a number of actions during the year which related to revenue and in particular substantive analytical review (in part in response to FRC and ICAEW findings in the prior year) but these actions were implemented following many of the audits inspected during this cycle being completed, so we do not yet see their impact.

We undertook root cause analysis which overall identified issues relating to inherent knowledge, prioritisation, coaching and sharing of knowledge in the areas where the FRC identified findings. In particular, we identified that in a number of instances, findings related to substantive analytical review ("SAR") related to the non-significant risk aspect of the revenue testing. Prioritisation of review time on these audits had been in the areas of revenue that had been identified as significant risk, which is a positive action, however, this led in some instances of insufficient review by an appropriately experienced team member of the design and execution of substantive analytical procedures. The substantive analytical review procedures and some of the controls work related to the findings were often performed by staff who were not sufficiently trained to be able to stand back and evaluate the impact of the results of the audit procedures and the exceptions identified. The insufficient review of this work because of the prioritisation of time noted above led to these gaps not being identified or addressed.

Actions that we have already taken during the year to address the root causes identified include:

- A 'Substantive Analytical Review (SAR) Revenue deep dive' in our mandatory monthly professional training update in September 2020. This focused on appropriate planning, testing requirements including use of independent data sources and threshold calculations and how to avoid common pitfalls. This training was mandatory for our assistant manager grades and above.
- A mandatory session on auditing revenue, which included the use of SAR within our Engagement Team Based Learning ("ETBL") coaching sessions for the 2020 programme. This focused teams on the overall approach taken in order to ensure that our teams understood transaction flows and that audit tests were designed appropriately.
- In late 2020 we updated the guidance given to consulted parties about how to respond to the consultations audit teams are required to undertake when using the audit regression software analysis to audit both revenue and cost of sales to ensure that the consulted parties were being provided with all the relevant facts and circumstances when evaluating the appropriateness of using the software to assist us in performing substantive analytical procedures on both account balances in this way.
- We have held additional training sessions for our manager group which focused on reviewing skills with the aim of improving the quality of primary reviews undertaken. This will ensure appropriate focus is being placed on the review of areas where substantive analytical review is performed.

We also plan to do the following in order to address the root causes:

- For December 2021 year ends, we have introduced a new policy, which applies to listed and PIE entities in the UK and requires teams to identify and test the operating effectiveness of relevant controls for material revenue streams. Our main annual training ("TechEx"), includes a learning journey, comprised of various modules on internal controls, including a focus on the new policy as a hot topic and a deep dive session on revenue review controls.

- Our TechEx training also includes a module on evaluating General IT Control deficiencies and will include recent FRC and internal review findings related to IT controls in order to enhance the quality of work performed in auditing revenue where controls are being relied upon. In relation to SAR specifically, we continue to believe that substantive analytical procedures, when performed well, provides persuasive audit evidence that can be more effective than tests of detail. However, we acknowledge that significant auditor judgement is required when performing substantive analytical procedures and recognise that we need to better support audit practitioners making those judgements. In particular, we are reflecting on the further enhancements we can make to help avoid pitfalls that we have seen in inspections. We are also holding workshops with practitioners to seek to identify other enhancements that could be made to tools, templates and training.
- The Deloitte Substantive Analytic Review Guide is also being updated to incorporate our learnings from these audit inspections and will be released shortly.

Good practice



We identified examples of good practice in the audits we reviewed, including the following:

- **Robust procedures relating to going concern:** Covid-19 started to have an impact on going concern assessments this year. The firm enhanced its procedures to respond to the increased risks relating to going concern. This included the use of technical panels on certain high-risk audits, which involved the national risk partner, restructuring and other partners who challenged audit teams on their going concern conclusions. We observed examples of good practice on eight audits where there was a heightened going concern risk. On these the audit teams used a wide range of procedures, including the use of the technical panels and specialists, to evaluate and challenge aspects of the going concern models and forecasts.
- **Evidence of challenge of management in areas of key judgement:** On three audits, there was good evidence of how the audit teams had challenged management in key audit areas. In one case, this resulted in an enhancement to the financial statement disclosures. The challenge of management, on another audit resulted in the firm delaying their audit report until sufficient audit evidence had been obtained. As highlighted in the key findings above, we have equally identified instances where audit teams did not sufficiently challenge management. The firm should address the inconsistency and use these examples of good practice to assist in their remediation.
- **Revenue - use of bespoke data analytic procedures:** We saw a good example of the use of bespoke data analytic procedures to obtain audit evidence and provide assurance over unbilled revenue. This was an effective way of auditing the related estimates generated from a diverse set of data.
- **Use of internal experts and specialists:** We continued to see good examples of audit teams utilising the firm's internal experts and specialists to support their knowledge of the industry and use this knowledge effectively to challenge management on three of the audits we reviewed.
- **Acceptance and continuance procedures:** The firm introduced a system to give advance notice to entities where they have significant concerns which could impact on their ability to continue to act as auditor. We have seen evidence of the auditors communicating concerns to the entity's management and to the Audit Committee, requesting specific action and improvement. Where the firm resigned as auditors, this information was shared with the incoming auditor and disclosed publicly within Deloitte's statement of circumstance, thereby improving overall transparency.

Good practice examples included robust procedures related to going concern, enhanced acceptance and continuance procedures and good use of internal experts.

3 Review of firm-wide procedures

We review firm-wide procedures, based on those areas set out in International Standard on Quality Control (UK) 1 (ISQC1), in some areas on an annual basis and others on a three-year rotational basis. The table below sets out the areas we have covered this year and in the previous two years:

Annual	Current year 2020/2021	Prior year 2019/2020	Two years ago 2018/2019
<ul style="list-style-type: none"> • Audit quality initiatives, including action plans to improve audit quality. • RCA process. • Audit quality focus and tone of the firm’s senior management. • Complaints and allegations processes. 	<ul style="list-style-type: none"> • Audit methodology and training. 	<ul style="list-style-type: none"> • Partner and staff matters. • Acceptance and Continuance (A&C) procedures. 	<ul style="list-style-type: none"> • Ethics and Independence. • Internal Quality Monitoring. • Quality Control matters (including consultation and EQCR). • Audit documentation and data security.

In this section we set out the key findings and good practice we identified in the firm-wide work we have conducted this year, and a summary of our findings reported publicly in the previous two years, and the firm’s related actions, with updates where relevant, as follows:

- Audit quality initiatives.
- RCA process.
- Audit methodology and training.
- Firm-wide findings and good practice in prior inspections.

Audit quality initiatives

Background

Firms should develop audit quality plans that drive measurable improvements in audit quality. Audit quality plans should include initiatives which respond to identified quality deficiencies as well as forward-looking measures which contribute directly or indirectly to audit quality.

Deloitte has been proactive at updating and enhancing the format of its AQP. The current plan now encompasses a broader range of the firm’s audit quality initiatives including those that are longer-term and more forward-looking. The plan incorporates requirements set by the global firm, supplemented by UK specific procedures.

The firm recently established an independent AGB which has responsibility for the oversight of the plan and more widely, audit risk and quality.

Audit quality plans should include forward-looking measures which contribute directly or indirectly to audit quality.

When we reviewed the AQP last year, we identified good practices relating to project management procedures whereby clear targets are set to enable monitoring of key phases of the audit. We also stated that the firm should improve the plan, particularly in relation to:

- Strengthening the procedures to monitor audit quality initiatives.
- Strengthening the culture of challenge in the audit process, including in relation to the challenge of management.
- Increasing the number of in-flight reviews.

This year, we have not conducted a detailed benchmarking of all firms' audit quality plans and quality initiatives, but at each of the seven firms we have brought our view up to date by work including:

- Assessing any key changes to the firm's AQP, arising from the actions taken in response to our findings last year, or for other reasons.
- Undertaking meetings with the firm to discuss and challenge aspects of the AQPs.
- Considering the oversight of the AQP at the firm including presentations made to the Independent Non-Executives (INEs) and any audit oversight bodies.
- Assessing the extent to which culture and the culture of challenge have been incorporated into the AQP.
- Considering, in hindsight, the effectiveness of the AQP and key initiatives with reference to current year findings and observations.

As a result of our work, we have observed that:

- There have been a number of changes to the format of the AQP. Each has sought to build upon and enhance the previous version and has been responsive to feedback from the FRC. This has meant that until recently, the information provided to the relevant boards and to the INEs did not encompass all the key audit quality initiatives. From April 2021, the breadth and extent of the plan has increased to cover more key initiatives. This will allow more effective monitoring and challenge. It is important that the plan becomes embedded and the newly formed AGB continues to build their oversight and challenge of this and the underlying quality initiatives.
- The number of in-flight reviews has not increased to the firm's target level and remains below that at some other firms. However, this has been partially compensated by other in-flight activities (for example, incremental in-flight reviews and thematic in-flight reviews where the audit response to broader themes is considered).

Audit Quality Indicators have been developed and are regularly reported to the AGB. The firm has continued to develop a central programme around higher risk audits and introduced other initiatives, such as building a new risk sensing group that identifies companies and information on certain risk characteristics and introducing a specialist panel to help challenge particularly complex or judgemental areas.

Key findings



We identified the following key findings where the firm needs to:

- Strengthen the procedures to monitor the effectiveness of the AQP: while the firm has developed its AQIs and tracks the milestones set for individual key initiatives, there is no monitoring of the overall effectiveness of the AQP.
- Continue to strengthen the culture of challenge in the audit process and more fully embed audit culture into the plan: the prior year key findings in our public report included this area. While a number of processes have been introduced to increase the level of central oversight and additional audit requirements have been mandated, the culture of challenge in the audit process needs to be more directly addressed. In addition, while the plan includes references to culture, this would be further strengthened by incorporating the findings of the working group that is focused on audit culture.

Good practice



We identified the following areas of good practice:

- **Clarity of the plan and linkage to ISQM 1:** the plan is well presented, clear and impactful. The initiatives are clearly linked to ISQM 1, with the status and key milestones included for each initiative.
- **Breadth of the plan:** the updated plan includes audit quality initiatives that cover a wide range of areas and are proactive as well as reactive.

We will continue to assess the AQP and encourage all firms to develop their audit quality plans, including the focus on continuous improvement and measuring the effectiveness of the key initiatives.

Firm's response and actions:



We have transformed our Audit Quality Plan through the year and completed an extensive exercise to capture the key actions being made in respect of audit quality. We are continually making changes to processes and controls across our audit practice in order to improve audit quality.

These actions, including responses to regulatory findings are captured within our Audit Quality Plan.

Progress in respect of the implementation of these actions is now monitored by the Audit Quality Board, the Audit & Assurance Executive and the newly established Audit Governance Board. Ultimately all actions will be captured through the ISQM 1 programme where a global framework is being developed which will serve to further strengthen our system of quality management.

There are a number of building blocks which help define the culture within the Audit and Assurance practice of Deloitte:

1. Organisation – how the organisation is structured and what is valued within the organisation.

Deloitte has recently enhanced the content of its audit quality plan, which is well presented.

2. Motivation – the reasons why people act in the way that they do.
3. Competence – the collective tools, skills and knowledge of and within the organisation.
4. Relationships – how people in the organisation interact with others.

There is continual challenge of and refinement in our processes and controls and the improvements we are making and monitoring through our Audit Quality Plan all influence the culture within the practice. We have made many changes to the practice over an extended period and we are committed to continue to learn from issues as they arise to further embed the culture we desire.

For many years our leadership messaging has highlighted the importance the firm places on audit quality. Recently within our leadership messaging, there has been more granular focus on the elements of audit quality including the importance of auditors adopting a challenge mindset.

Our values are reflected well in our highly prized quarterly Audit Quality Awards scheme, which recognises outstanding contributions across our audit practice including where our auditors have demonstrated 'courageous actions to protect the public interest'.

We have set up a People and Purpose working group which is focusing on culture, including the culture of challenge. One of our shared values is to act with integrity which includes objectively and independently assessing and challenging available evidence in order to assess the conclusions of management. This working group will in particular focus on embedding our shared values within the business and evolving our communications to ensure expectations are clear in respect of the need to challenge. Furthermore, the commitment of leadership to promote challenge manifests itself at the different levels within the organisation. This encompasses the overall Tone at Top, through to the challenge of audit teams from within Deloitte to the documentation requirements to ensure teams appropriately evidence the challenge provided. Specific additional actions from this working group will be incorporated into the Audit Quality Plan.

RCA process

Background

The RCA process is an important part of a continuous improvement cycle designed to identify the underlying causes of specific audit quality issues (whether identified from internal or external quality reviews, or other sources) so that appropriate responses can be taken that address the risk of repetition.

The firm has undertaken RCA for a number of years and follows methodology and guidance set out by the global firm, supplemented by UK specific procedures.

When we reviewed the firm's RCA process last year, we found that the firm had a well-developed process with various elements of good practice, such as the timeliness of reviews and the completion of team wide interviews as well as individual interviews. None-the-less, we found that the firm should further improve the RCA process, particularly in relation to the:

- Methods of identifying RCA themes, as this was a manual process that could be improved by a degree of automation.
- Reporting of good practices so these further highlighted good practices.

Root cause analysis is an important part of a continuous improvement cycle.

This year, we have not conducted a detailed benchmarking of all the firms' RCA processes, but at each of the seven firms we have brought our view up to date by performing work including:

- Assessing any changes to the firm's RCA process, arising from the actions taken in response to our findings last year, or for other reasons.
- Conducting follow-up meetings with the firm to discuss and challenge aspects of the RCA process.
- Considering the oversight of RCA at the firm and communication of key findings.
- Considering, in hindsight, the efficacy of the historical RCA process and the actions taken with reference to current year inspection findings.

As a result of our work, we have observed that:

- There is ongoing investment in the RCA team, all of whom have received RCA, psychology and behavioural training. The head of the UK RCA team also takes a leading RCA role for the global firm.
- The scope of RCA reviews includes all external inspections (including FRC, ICAEW and PCAOB), a sample of internal reviews and a sample from other sources (including prior period adjustments, first year audits and contentious / emerging issues). For firm-wide reviews, key FRC findings are subject to RCA and assessments of arising themes.
- The underlying RCA processes are well established. Certain enhancements have been made in the year, for example, improvements have been made in the recording of causal themes (to facilitate thematic analysis) and to the design of the database (for improved reporting).
- There is good communication of findings throughout the firm, including an increased focused on good practice findings.

Key Findings



We identified the following key finding where the firm needs to:

- **Improve the effectiveness of addressing recurring findings:** while the RCA process focuses on recurring findings, further analysis of the effectiveness of the approach and the appropriate remedial actions needs to be undertaken in respect of certain recurring findings.

Good practice



We identified the following areas of good practice:

- **Use of a dedicated RCA review team and established process:** the core RCA team is experienced and has received RCA, psychology, and behavioural training. Additional resources to support the RCA team are drawn from a pool of experienced partners and senior staff who have also received RCA training. The firm uses an established risk factor classification system which enables a consistent approach with a clear trail from the underlying finding to the causes and actions.

Deloitte's root cause analysis processes are well established.

- **Breadth of information used in RCA analysis:** the RCA team undertake various research and analysis ahead of RCA interviews. This facilitates a better-informed understanding and therefore more focused approach to the interviews. RCA interviews are undertaken on an individual basis (including where relevant, specialists) and with the team (including where relevant, component teams).
- **Continual RCA activities:** RCA reviews are conducted on an ongoing basis which ensures that engagement teams can promptly address any key findings. The RCA team can identify and respond to developing themes and good practice areas and share these on a timely basis.

We will continue to assess the firm's RCA process. We encourage all firms to develop their RCA techniques further as well as focus on measuring the effectiveness of the actions taken as a result.

Firm's response and actions:



We have continued to enhance and improve our RCA process with better linkage of our remedial actions to the causes of findings. Using the results of the RCA we have developed a number of actions, including in relation to findings which are recurring in nature. These are set out within this report.

We will continue to monitor both the completion of the actions and the effect on the overall number and nature of future findings. A number of the root causes are in part, behavioural in nature. In addition to the monitoring of whether actions have been completed, for certain actions we plan to perform a more focused assessment to qualitatively ascertain whether the actions being implemented are having the desired effect on audit teams and behaviours or whether further changes are required. This will involve performing focused assessments on a sample of audits.

We note the areas of good practice identified by the FRC and will continue to strengthen our RCA process.

Audit methodology and training

Background

The firm's audit methodology and the guidance provided to auditors on how to apply it are important elements of the firm's overall system of quality control. Our inspection primarily evaluated key changes to the firm's methodology and guidance including how it had been updated to incorporate recent changes to auditing and accounting standards, including:

- ISA 540 revised (Auditing accounting estimates and related disclosures).
- ISA 570 revised (Going concern).
- IFRS 9 (Financial instruments) with a focus on the audits of banks, building societies and other credit institutions (banking audits).
- IFRS 16 (Leases).

We also considered other key topics such as the policies for using specialists and experts on audits and updates to audit software. We performed the majority of this work on methodology and guidance in place on 31 March 2020, including a consideration of the firm's initial response to the impact of Covid-19.

The firm's audit methodology and the guidance provided to auditors on how to apply it are important elements of the firm's overall system of quality control.

Firms' training arrangements must provide auditors with the knowledge and skills necessary to fulfil their role effectively, and as such, are also an important element of the firm's overall system of quality control. Our inspection included an evaluation of the amount of training provided by the firm in the year ended 31 March 2020, the subjects covered and how the training was delivered. We also considered the firm's processes for monitoring course attendance and evaluating whether participants had met the learning objectives by conducting post-course assessments.

Key findings



We had no key findings to report.

Good practice



We identified the following areas of good practice:

- **The firm has established a centre of excellence team focused on credit that is used on banking audits:** the firm mandates that audit teams involve the credit centre of excellence team at each stage of the audit to encourage the consistent application of the firm's methodology and guidance.
- **The illustrative audit procedures provided to teams performing banking audits:** the firm issues audit teams with illustrative examples of controls testing and substantive procedures that can be used to audit common risks, including those relating to the allowance for expected credit losses.

In addition to the firm-wide procedures above, we performed a thematic review on the enhanced audit policies and procedures at the seven largest firms in relation to going concern, given the impact of Covid-19. The themes we observed were publicly reported in [June 2020](#) and [November 2020](#) and have not been included here.

Firm's response and actions:



We welcome the FRC's good practice observations and are pleased that the work we have done to continue to develop and implement our approach has been recognised. The audit of incurred and expected credit loss provisions is a critical part of many of our audits, particularly of our audits of banks and other lending institutions and requires significant auditor judgement in assessing the appropriateness of many aspects of the provisions. We have invested significantly over the last four years in developing our programme of support to audit teams which includes the development of the Credit Centre of Excellence but also the learning, guidance, tools and templates referred to above. We recognise the importance of continuing to develop our audit approach and the materials that support the implementation of that approach, particularly as the credit environment changes and our portfolio of audits also changes, and therefore have committed to do that.

We had no key findings to report in respect of audit methodology and training.

Firm-wide key findings and good practice in prior inspections

Key findings



There were no key findings included in our previous two public reports in those areas of ISQC 1 which we review on a rotational basis.

Good practice



The following observations were highlighted as good practice in relation to our firm-wide inspection work in the previous two years:

Partner and staff matters (2019/20)

- The effective use of a wide range of audit quality metrics to assess partners and staff performance.
- Incorporation of upward feedback into the partner appraisal and promotion process.
- Robust processes for the centralised review and monitoring of partner portfolios.

A&C procedures (2019/20)

- The effective interaction of the firm's finance and resourcing systems with A&C process, to monitor resourcing needs in real time.

Internal quality monitoring (2018/19)

- The development of a suite of in-flight review procedures on audits, including health checks, diagnostics and in-flight reviews, to monitor and enhance audit quality throughout the audit.
- Effective integration of the firm's internal quality monitoring programme into the wider audit quality programme, with more risk-focused reviews, particularly consideration of issues arising from regulatory reviews.

Appendix 1

Firm's internal quality monitoring

This appendix sets out information prepared by the firm relating to its internal quality monitoring for individual audit engagements. We consider that publication of these results provides a fuller understanding of quality monitoring in addition to our regulatory inspections, but we have not verified the accuracy or appropriateness of these results.

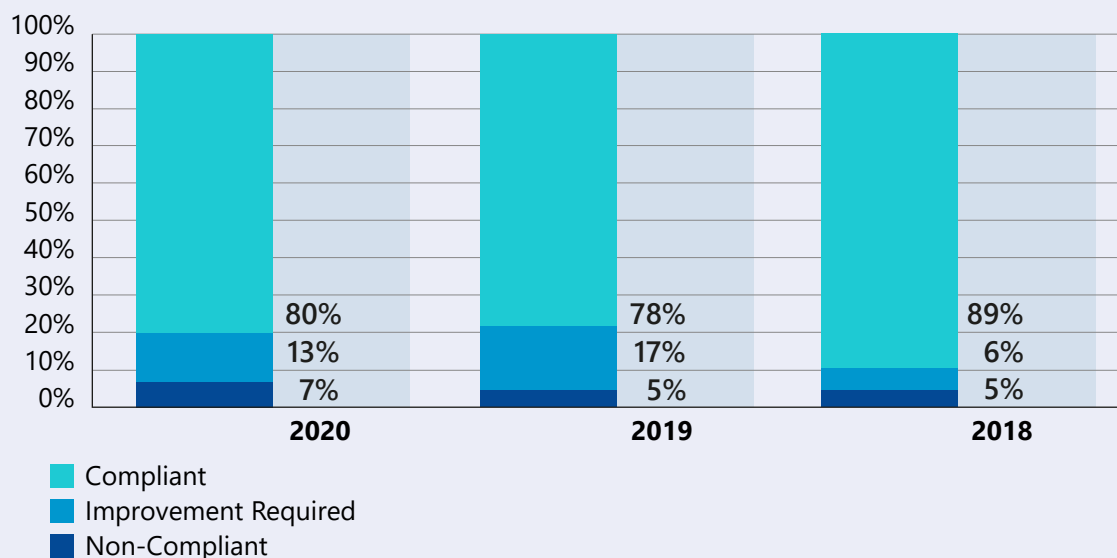
The appendix should be read in conjunction with the firm's [Transparency Report](#) for 2020, which provides further detail of the firm's internal quality monitoring approach and results, and the firm's wider system of quality control.

Due to differences in how inspections are performed and rated, the results of the firm's internal quality monitoring may differ from those of external regulatory inspections and should not be treated as being directly comparable to the results of other firms.

Results of internal quality monitoring



The results of the firm's most recent archived engagement review, which comprised internal inspections of 90 individual archived audits with opinions signed between 1 June 2019 and 31 May 2020 (2019 – 79), are set out below along with the previous two years.



Archived engagement reviews are assigned an overall evaluation rating based on the engagement review findings noted. The ratings received are classified as either Compliant, Improvement Required or Non-Compliant. A Compliant rating indicates there are no exceptions or the exceptions identified are of a very minor nature relating to isolated instances of non-compliance with certain policies, requirements or standards; an Improvement Required rating indicates that there are a small number of findings relating to these areas, whereas a Non-Compliant rating indicates that non-compliance with several policies, requirements or professional standards or an individually significant matter was identified and it cannot be determined that policies, requirements or professional standards reviewed are fully implemented.

Firm's approach to internal quality monitoring



The firm's internal inspection programme considers the full population of audits performed. Engagements are selected using a risk based approach, focusing on high risk and/or high profile engagements, and to ensure that, as a minimum, each Responsible Individual is subject to review every three years. The firm aims to review FTSE 350 engagements every five years. Selected files are then subject to independent inspection by professionals comprising partners and senior auditors from the UK and overseas member firms. All members of the inspection team are given thorough training by the leaders in the central inspection team. All reviews of FTSE 350 engagements involve a professional who has undergone regulatory review themselves in order to apply a 'regulatory lens' to the review.

For all internal inspections, the firm uses moderation panels to rate individual findings and the overall engagement and takes into account the ratings applied by regulators when doing so. The moderation panel will normally include three members and will be comprised of partners and directors in the central Audit Quality Monitoring and Measurement team and experienced partners from the UK or overseas member firms. These panellists are independent from the audit team and the team that undertook the inspection.

The firm undertakes RCA for all improvement required and non-compliant engagement inspections, as well as on a sample of positive results to identify factors to support audit quality. The firm performs retrospective remediation of all high and medium findings for an improvement required or non-compliant rated engagement, and prospective remediation on all findings regardless of the engagement rating in the subsequent year's audit.

Internal quality monitoring themes arising



Progress has been made in a number of key areas of focus from prior years, including aspects of group audits and testing of information provided by the entity but we have seen an increase in findings in the testing of accounting estimates and the use of substantive analytical procedures. The main areas where findings were identified in the current year related to reporting and concluding procedures, identification of risk and journal entry testing.

Firm's actions



Readers should note an improvement in results of our internal inspection programme in the current year compared to prior year. Having evaluated the results we consider this improvement to be largely attributable to the impact of the audit quality actions taken in previous years to address findings previously identified. Our objective remains to ensure our internal inspection process assesses the quality of our audits against the highest bar possible. To do this we take into account the expectations of our regulators, including the FRC, the ICAEW and the PCAOB, as well as our own Deloitte global quality standards, and continue to ensure our inspections are robust by pushing our reviewers to be granular in their approach to reviewing, and to employ an even greater level of professional scepticism.

Internal quality monitoring is only one of the firm's measures of audit quality. Audit quality monitoring is reported to and considered by our Audit Governance Board and UK Oversight Board (including our Independent Non Executives) using a range of measures.

Whilst the firm tries to at least mirror the processes of the external regulator due to differences in how inspections are performed and rated, the results of the firm's internal quality monitoring may differ from those of external regulatory inspections and other firms.

Our overall aim is that our internal inspections serve as one of our tools to drive continuous improvement in audit quality. We place our focus on rigorous compliance with applicable standards, also taking into account the approaches adopted by our external regulators. We perform a wide and detailed in-depth review seeking to identify areas to be improved on individual audits. We continually assess and seek feedback on our internal monitoring process to make further enhancements to support the delivery of audit quality.

The firm's RCA for the most recent internal inspections programme identified a number of thematic root causes of findings. These were in the areas of:

- *Mind-set related root causes* due to inherent knowledge, where information or evidence that is considered obvious to the engagement team (as a result of their knowledge of the entity or industry expertise) is not included on the audit file to 'tell the story', and examples in individual portfolios of prioritisation of higher risk areas of audit work.
- *Resourcing and deployment root causes* with examples of capacity challenges and work allocation to junior staff on individual engagement teams.
- *Skillset root causes* with examples of certain gaps in knowledge or experience, or particular industry/accounting matters at either preparer or reviewer level.

Positive root causes were also identified including examples of:

- the benefits of upfront planning;
- early partner involvement; and
- good project management.

Thematic causes from engagement reviews were communicated to the business unit leaders and to the practice to increase awareness of the common pitfalls together with positive causal factors identified.

Key actions being taken include:

- introduction of enhanced audit tools and centres of excellence covering key aspects of the audit to improve the quality and consistency of audit challenge;
- increased use of Challenge Panels on our more complex and highest risk engagements;
- increased focus on capacity as part of our portfolio risk review; and
- enhanced learning materials, guidance, coaching and support programmes to address identified skillset gaps.

Appendix 2

FRC audit quality objective and approach to audit supervision

Audit quality objective

The FRC is the Competent Authority for statutory audit in the UK and is responsible for the regulation of UK statutory auditors and audit firms, and for monitoring developments, including risk and resilience, in the market. We aim, through our supervision and oversight, to develop a fair, evidence-based and comprehensive view of firms, to judge whether they are being run in a manner that enhances audit quality and supports the resilience of individual firms and the wider audit market. We adopt a forward-looking supervisory approach to audit firms, and we hold firms to account for making the changes needed to safeguard and improve audit quality.

Auditors play a vital role in upholding trust and integrity in business by providing opinions on financial statements. The FRC's objective is to achieve consistently high audit quality so that users of financial statements can have confidence in company accounts and statements. To support this objective, we have powers to:

- Issue ethical, audit and assurance standards and guidance;
- Inspect the quality of audits performed;
- Set eligibility criteria for auditors and oversee delegated regulatory tasks carried out by professional bodies such as qualification, training, registration and monitoring of non-public interest audits; and
- Bring enforcement action against auditors, if appropriate, in cases of a breach of the relevant requirements.

In March 2021 the Department for Business Energy & Industrial Strategy (BEIS) published a consultation document, *Restoring Trust in Audit and Corporate Governance*, which proposes broader supervisory powers for the FRC/ARGA covering auditors, audit committees and directors. The legislation that follows the consultation process will create ARGAs and provide it with further powers.

Approach to audit supervision

In March 2021 we published [Our Approach to Audit Supervision](#) which explains the work that our audit supervision teams do.

These reports published in July 2021 provide an overview of the key messages from our supervision and inspection work during the year ended 31 March 2021 (2020/21) at the seven largest audit firms¹¹, and how the firms have responded to our findings.

In accordance with our commitment to transparency, for the first time we will also be publishing later this year anonymised details of the key inspection findings and good practice points on the individual audits we reviewed.

In addition to our public reporting, we report our findings in more detail privately to the firms and also to their Recognised Supervisory Body for the purposes of its decision on their audit registration. From 2022, the FRC will be assuming responsibility for the registration of all firms which audit PIEs.

¹¹ The seven largest firms are: BDO LLP, Deloitte LLP, Ernst & Young LLP, Grant Thornton UK LLP, KPMG LLP, Mazars LLP, PricewaterhouseCoopers LLP. We have published a separate report for each of these seven firms.

Our inspection and supervisory work in 2020/21 included:

- 103 statutory audits conducted by the largest seven firms, 16 at smaller firms and four at the National Audit Office. These audits were of financial statements for years ended between 30 June 2019 and 2 May 2020. We also inspected 22 local audits, which we report on separately later in the year, three other audits at the National Audit Office and one Third Country Audit, making an overall 149 inspections.
- Certain areas of the firms' quality control procedures (against the requirements of ISQC 1). We review these on a three year rotation basis at the seven largest audit firms and periodically for smaller firms.
- A focus on the firms' audit quality plans and RCA, both of which are important means of addressing audit quality issues and driving continuous improvement.

In 2020/21 our inspections focused on the following priority sectors and audit areas¹²:

Sectors	Audit areas
<ul style="list-style-type: none">• Financial Services• Retail, including Retail Property and Travel & Leisure• Construction and Materials• Manufacturing	<ul style="list-style-type: none">• Going concern and the viability statement• The Other Information in the Annual Report• Long-term contracts• The impairment of non-financial assets• Fraud risk• Application of new accounting standards (IFRS 15: revenue and IFRS 16: Leasing)

Our firm-wide inspection work in 2020/21 focused on audit firms' methodology and training, particularly relating to: revised auditing standards on going concern and the audit of estimates; and new or recently issued accounting standards on financial instruments (IFRS 9), revenue (IFRS 15) and leasing (IFRS 16).

At the conclusion of all individual audit inspections that are assessed as requiring more than limited improvements, we will consider whether the audit should be referred for consideration under the FRC's enforcement procedures. UK statutory audits may be referred to FRC's Case Examiner for consideration under the Audit Enforcement Procedure (AEP)¹³. The Case Examiner then decides on the appropriate course of action, which may involve Constructive Engagement with the audit firm to resolve less serious potential breaches of auditing standards and other requirements or referral to the FRC's Conduct Committee to consider whether an investigation should be opened. An investigation may result in financial and non-financial sanctions being imposed on an individual statutory auditor and/or the statutory audit firm. The FRC publishes details of all sanctions imposed. From our 2020/21 inspections, 18 audits have so far been referred to the Case Examiner (compared to 13 from our 2019/20 inspection cycle). The FRC's Annual Enforcement Review, published annually in July, contains further details of audits considered under the AEP.

As well as planned supervision and inspection activities, we also respond quickly to emerging issues. For example, during 2020/21 we responded to Covid-19 by issuing guidance to audit firms (and companies) and carrying out a thematic review of the audit of going concern which included inspecting samples of audit work. Our findings were that firms had reacted well to the new challenges. Our 2021/22 inspections will also focus on and take into account the impact of Covid-19 on audits.

¹² [https://www.frc.org.uk/news/december-2019-\(1\)/frc-announces-its-thematic-reviews-of-corporate-re](https://www.frc.org.uk/news/december-2019-(1)/frc-announces-its-thematic-reviews-of-corporate-re)

¹³ Other procedures apply to audits of non-UK entities (such as those incorporated in the Crown Dependencies)



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