



Financial Reporting Council

Auditor reporting: A review of current practice

August 2022

Contents

	Page
1 Executive summary	2
2 Background	3
3 Study design	4
4 The sample	5
5 The snapshots	10

The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

© The Financial Reporting Council Limited 2022

The Financial Reporting Council Limited is a company limited by guarantee.

Registered in England number 2486368. Registered Office:

8th Floor, 125 London Wall, London EC2Y 5AS

1. Executive summary

1. Auditor's reports are the principal channel of communication between auditors and users of financial statements, providing insights on the auditor's assessment of risks of material misstatements as well as how the auditor has set about responding to those risks. The detail and insight provided by these reports have been welcomed. Recent audit market reviews have nevertheless suggested further enhancements to improve the 'decision usefulness' of the financial information companies publish.¹ Concerns have also been expressed that, after an initial burst of innovation, auditor's reports have become too lengthy and now contain too much standardised and boilerplate disclosures.
2. The FRC has committed to considering the quality, relevance, and accessibility of current market practice, whilst ensuring that auditor's reports are as concise as possible. Earlier FRC reports on auditor reporting are now over five years old.
3. To address this evidence gap, the FRC commissioned research into the current state of auditor reporting within the UK. A sample of nearly 400 auditor's reports for companies in the FTSE 350, as well as large AIM companies, has been used to explore their form and content. The findings have been summarised as a series of six 'snapshots' to start a dialogue with stakeholders on how auditor's reports can be further improved.

¹ Sir Donald Brydon, [Assess, assure and inform: Improving audit quality and effectiveness](#) (December 2019).

2. Background

4. The auditor's report was introduced in response to concerns following the financial crisis of 2008 that the pass or fail nature of extant auditor reporting provided inadequate transparency about both the audit and the auditor's insights into the company. In response, the FRC introduced a suite of coordinated improvements in 2014 to both the auditing standards and corporate governance rules. These changes were intended to provide users of financial statements with greater confidence in the integrity and reliability of financial reporting, and in the audit process.
5. Auditors were required to include a description of the assessed risks of material misstatement that were identified and which of those had the greatest effect on the overall strategy, the allocation of resources in the audit, and directing the efforts of the engagement team. The auditor was also expected to provide information on how the auditor applied the concept of materiality and a summary of the scope of the audit.
6. The International Auditing and Assurance Standards Board introduced similar changes to auditor reports through the development of a new auditing standard which was subsequently adopted by the UK for audits of financial statements from June 2016.² Auditors of public interest entities have also been required to explain the extent to which the audit was considered capable of detecting irregularities, including fraud, since the same date.³ This latter requirement was extended to all entities from December 2020.⁴
7. These changes have been welcomed by external stakeholders and represented a step change in the quality and quantity of information available on the design and conduct of a financial statement audit.
8. Following a number of high-profile corporate failures, the Government commissioned a review by Sir Donald Brydon to recommend ways to improve the quality and effectiveness of external audit.⁵ The Brydon review included proposals to improve continuity between successive auditor's reports for the same company, and to provide greater transparency to users over the use of estimates by different companies. Other proposals included requiring auditors to report on inconsistencies between the auditor's findings and information made public by the company, and to make reference to external market signals and disclose how they have informed the audit.
9. In response to the Brydon review as well as other reports commissioned into the operation of the FRC and the UK audit market, the Department of Business, Energy & Industrial Strategy initiated a consultation on the proposed implementation of these proposals.⁶ The FRC also performed a review of auditor reporting, which also fed into the Department's considerations.

² ISA (UK) 701 [Communicating Key Audit Matters in the Independent Auditor's Report](#) (June 2016).

³ ISA (UK) 700 (Revised June 2016) [Forming an Opinion and Reporting on Financial Statements](#).

⁴ ISA (UK) 700 (Revised November 2019) [Forming an Opinion and Reporting on Financial Statements](#).

⁵ Brydon, [Assess, assure and inform](#) (December 2019).

⁶ Department of Business, Energy & Industrial Strategy, [Restoring trust in audit and corporate governance: Consultation on the government's proposals](#) (March 2021). The consultation also responded to Sir John Kingman, [Independent review of the Financial Reporting Council](#) (December 2018), and Competition & Markets Authority, [Statutory audit services market study: Final report](#) (April 2019).

-
10. The Department's response to the consultation, published in May 2022, made a commitment to consider the recommendations of the Brydon review to provide users with more meaningful and useful information, whilst also ensuring that reports are clear, concise, and accessible.⁷ The FRC has therefore undertaken to take steps to improve the useability and informativeness of the audit process to stakeholders, while at the same time minimising divergence between the UK and international standards.⁸
11. To support the identification of potential further enhancements, the FRC commissioned research to review current practice for the auditor's report with the intention of creating a firm empirical basis to establish the principal characteristics of reports, as well as how they communicated information on risks, scope, and materiality to users. The FRC have previously reported on auditor reporting, in 2015 and 2016.⁹ Ongoing innovation in practice as well as the introduction of new auditing standards effective from December 2020 create a strong need to establish a new baseline to understand current practice.

⁷ Department of Business, Energy & Industrial Strategy, [Restoring trust in audit and corporate governance: Government response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems](#) (May 2022), pp. 86-7.

⁸ Financial Reporting Council, [Position paper: Restoring trust in audit and corporate governance](#) (July 2022), p. 7.

⁹ Financial Reporting Council, [Extended auditor's reports: A review of experience in the first year](#) (March 2015); Financial Reporting Council, [Extended auditor's reports: A further review of experience](#) (January 2016).

3. Study design

12. To establish a factual backdrop for current practice, the FRC commissioned a team of researchers from the University of Portsmouth, Southampton, and Brunel to undertake a survey of auditor's reports issued during 2021. This team was led by Dr Tarek Abdelfattah at the University of Portsmouth as Principal Investigator and included Dr Mohamed Elmahgoub (University of Southampton), Dr Ahmed Elamer (Brunel University London), Prof Collins Ntim (University of Southampton), and Dr Nurul Hidayah (University of Southampton). The FRC expresses its thanks to the team for their work.
13. The sample includes all auditor's reports issued for companies listed on the London Stock Exchange Main Market, included in the FTSE 100 and FTSE 250 market indices, and audited in accordance with the International Standards on Auditing (UK). The study design also took into account the issue of new audit reporting requirements for periods ending after 15 December 2020. Accordingly, all auditor's reports issued for companies with reporting dates after 15 December 2020 were determined to be within the scope of the study. The composition of the FTSE 100 and FTSE 250 were taken at the end of September 2021.
14. Unlike previous studies, the current sample also includes auditor's reports issued for the largest companies listed on the London Stock Exchange's Alternative Investment Market (AIM). The reasons for this decision were threefold. Firstly, this would facilitate comparison of auditor reporting practices for companies outside the FTSE 350. It would also facilitate comparisons on reporting practice for a larger number of audit firms, due to the very high proportion of FTSE 350 companies that are audited by the Big 4 firms. Finally, companies listed on the AIM are not subject to the same regulatory requirements for disclosing information to the market as those listed on the Main Market. In consequence, the auditor's report for an AIM entity potentially represents a greater proportion of the total quantity of publicly disclosed information on the performance of the audited company.

4. The sample

15. A total of 396 reports were included in the sample, which can be analysed according to the market segment from which the report is drawn, the audit firm that issued the report, and the industrial sector in which the company operates. Table 1 provides a breakdown of reports by market segment as of September 2021. The AIM companies were those with a market capitalisation of greater than €200m in September 2021, and therefore exceeding the criteria for treatment as a SME listed entity.¹⁰

Table 1: Analysis of auditor's reports surveyed by market segment

Market segment	Number of auditor's reports surveyed	Percentage of total
FTSE 100	93	23%
FTSE 250	201	51%
AIM	102	26%
Total	396	100%

16. Overall, just over half of the auditor's reports were issued for FTSE 250 companies, with FTSE 100 companies and large AIM companies constituting approximately a quarter each of the sample. Some companies in the three market segments were not audited in accordance with the ISAs (UK). In addition, a number of companies had financial year ends which meant that their annual reports were not issued before data collection was completed in December 2021. This explains why the total of FTSE 100 companies does not equal 100, or the total of FTSE 250 companies does not equal 250.
17. Table 2 shows the composition of the sample by audit firm. In total, 82% of the auditor's reports surveyed were issued by the 'Big 4' firms – Deloitte, EY, KPMG, and PwC. This proportion varied by market segment, with all the FTSE 100 reports and 89% of FTSE 250 reports being issued by these four firms. A total of 11 other audit firms have been grouped together as 'Challenger' firms, and together account for 18% of all reports in the sample. However, these firms issued nearly half the reports issued for large AIM companies and included in the sample. Reports issued by BDO (8% of the total sample), Grant Thornton (4%), and RSM UK (2%) formed the bulk of the Challenger category.

¹⁰ Financial Reporting Council, [Glossary of terms \(auditing and ethics\)](#) (December 2019).

Table 2: Analysis of auditor's reports surveyed by audit firm and market segment

Audit firm	Market segment							
	FTSE 100		FTSE 250		AIM		Total	
	No	%	No	%	No	&	No	%
Deloitte LLP	21	22%	42	21%	13	13%	76	19%
EY LLP	24	26%	39	19%	7	7%	70	18%
KPMG LLP	25	27%	40	20%	13	13%	78	20%
PwC LLP	23	25%	58	29%	19	18%	100	25%
Total Big 4	93	100%	179	89%	52	51%	324	82%
BDO LLP	0	0%	14	7%	19	18%	33	8%
Crowe UK LLP	0	0%	0	0%	3	3%	3	1%
Grant Thornton UK LLP	0	0%	5	3%	10	10%	15	4%
Jeffreys Henry LLP	0	0%	0	0%	1	1%	1	0%
Kreston Reeves LLP	0	0%	0	0%	1	1%	1	0%
Mazars LLP	0	0%	0	0%	1	1%	1	0%
MHA MacIntyre Hudson LLP	0	0%	2	1%	0	0%	2	1%
Moore Kingston Smith LLP	0	0%	0	0%	2	2%	2	1%
PKF Littlejohn LLP	0	0%	0	0%	4	4%	4	1%
RMT Accountants & Business Advisors Ltd	0	0%	0	0%	1	1%	1	0%
RSM UK Audit LLP	0	0%	1	0%	8	8%	9	2%
Total Challenger	0	0%	22	11%	50	49%	72	18%
Total	93	100%	201	100%	102	100%	396	100%

18. A breakdown of auditor's reports in the sample by industrial sector is provided in Table 3. This follows the Industrial Classification Benchmark (ICB) scheme used by the London Stock Exchange.¹¹ Financial services form the single largest element, with just over one fifth of surveyed reports being issued for companies in this sector. Industrial goods and services (15%), real estate (7%), technology (7%), health care (6%), and basic resources (5%) all exceed 5% of the total sample. There are also noticeable differences between market segments, with one third of FTSE 250 reports issued for financial services companies, while technology companies formed twice the proportion of AIM reports surveyed (15%) than in the overall sample.

Table 3: Analysis of auditor's reports surveyed by audit firm and industrial sector

Industrial sector	Market segment							
	FTSE 100		FTSE 250		AIM		Total	
	No	%	No	%	No	%	No	%
Automobiles & Parts	0	0%	2	1%	0	0%	2	1%
Banks	5	6%	2	1%	0	0%	7	2%
Basic Resources	8	8%	6	3%	8	7%	22	5%
Chemicals	2	2%	2	1%	0	0%	4	1%
Construction & Materials	0	0%	7	3%	3	3%	10	3%
Consumer Products & Services	6	7%	6	3%	8	7%	20	5%
Energy	2	2%	5	3%	5	5%	12	3%
Financial Services	10	11%	67	33%	6	6%	83	21%
Food, Beverage & Tobacco	4	4%	4	2%	5	5%	13	3%
Health Care	4	4%	8	4%	12	12%	24	6%
Industrial Goods & Services	16	17%	26	13%	19	19%	61	15%
Insurance	5	6%	5	3%	1	1%	11	3%
Media	5	6%	2	1%	4	4%	11	3%
Personal Care, Drug & Grocery Stores	6	7%	2	1%	2	2%	10	3%

¹¹ For a description of the scheme, see <https://www.ftserussell.com/data/industry-classification-benchmark-icb>.

Industrial sector	Market segment							
	FTSE 100		FTSE 250		AIM		Total	
	No	%	No	%	No	&	No	%
Real Estate	4	4%	19	9%	5	5%	28	7%
Retail	3	3%	10	5%	5	5%	18	4%
Technology	4	4%	9	4%	15	15%	28	7%
Telecommunications	2	2%	4	2%	1	1%	7	2%
Travel & Leisure	3	3%	10	5%	3	3%	16	4%
Utilities	4	4%	5	3%	0	0%	9	2%
Total	93	100%	201	100%	102	100%	396	100%

5. The snapshots

19. The analysis of the 396 auditor's reports have been presented as six thematic infographics, or snapshots. These present the findings in an accessible and visual format, with the intention of initiating a conversation with stakeholders on how auditor's reports can be improved. This is to ensure they present information that is both meaningful and useful in as clear and concise a manner as possible.
20. The first snapshot looks at the overall **useability and understandability** of auditor's reports. The snapshot explores how the length of reports varies between firms, industrial sectors, and market segments. Any view on the useability and understandability of an individual auditor's report is subjective and varies with the informational needs and perspectives of the user. This can complicate comparisons between different reports due to the absence of a common framework for assessment. However, objective measures such as readability scores and measurement of standardised or generic language within individual reports can be performed in a consistent fashion for all the reports in the sample. These measures can then be used as a proxy for understanding how useability and understandability varies across the market.
21. The second snapshot reviews how auditors have used their reports to **communicate judgements about materiality** and the **scope of group audits** to users. This includes setting out the basis of judgements for the selection of materiality and performance materiality, as well as decisions on the scoping and coverage achieved by group audits.
22. The third snapshot provides an overview on how auditors have approached reporting **Key Audit Matters** (KAMs). This includes a review of the number of KAMs in auditor's reports, and a survey of the most common types of risks of material misstatement across the entire sample. In addition, the snapshot reviews how auditors have communicated these risks, and how they communicated their findings from the audit procedures addressing those risks. This snapshot also reviews how KAMs interact with the rest of the company's annual report.
23. The next snapshot takes a deep dive into how KAMs in auditor's reports have addressed certain types of risks. These include risks arising from **climate change**, and the **COVID-19 pandemic**. The snapshot also examines how KAMs have addressed **alternative performance measures** used by management to report on a company's performance, as well as the classification of **exceptional items** within the financial statements. The COVID-19 pandemic resulted in the most significant period of economic turbulence since the financial crisis of 2008, which was the trigger for the introduction of auditor reporting. The response to COVID-19 therefore provides an opportunity to understand how auditors respond to difficult and pervasive economic conditions. This snapshot also explores the use of **graduated and binary findings** by auditors when reporting on KAMs. Graduated findings are where the auditor expresses an opinion on key management estimates and judgements within the financial statements by describing their position on a range of potential outcomes. An alternative but related approach is the use of binary findings, where the auditor reports on the comparison of management's point estimate with the plausible range of values identified by the auditor.

-
24. The auditor is also required by the auditing standards to report on the appropriateness of the use of the **going concern** assumption in the financial statements, and the fifth snapshot explores how auditors have approached these requirements. Auditors have adopted a variety of different approaches to structuring how this information is presented in the auditor's report, even if the underlying content is broadly similar between different audit firms.
 25. The final snapshot explores how auditors have responded to the new requirement to explain the extent to which their audit has been designed to detect **fraud and other irregularities**. As with going concern, auditors have used a range of different means to structure their reporting for this requirement. Detail is also provided on the types of risk that the auditors have identified, as well as the audit responses that they have adopted in response to risks posed by fraud and potential non-compliance with laws and regulations by the company.



Financial Reporting Council

**Financial
Reporting Council**

8th Floor
125 London Wall
London EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk