



Snapshot 1: Understandability and useability of auditor's reports

Introduction

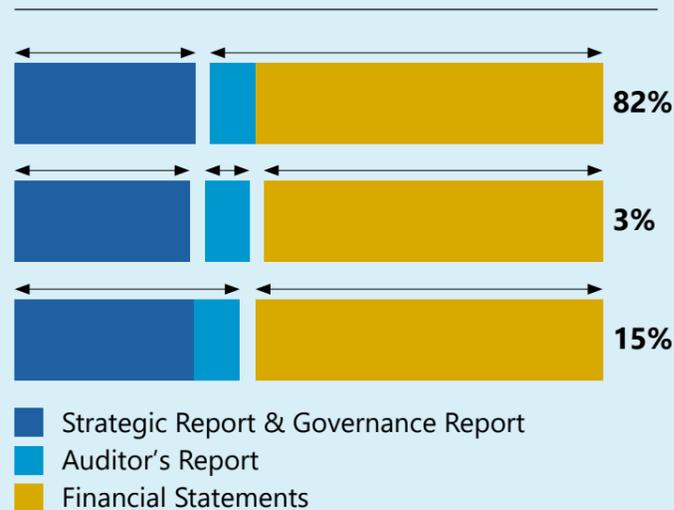
Auditor reporting is intended to enhance the communication of audit findings to users of financial statements. Judging the quality of this reporting is inherently subjective. Objective measures can instead be used to survey how auditor reporting varies between different companies, firms, and industrial sectors. This snapshot analyses 396 auditor's reports issued during 2021 for FTSE 350 and large AIM companies, and describes practice on report location, reporting of opinions, length, readability, and usage of boilerplate.

1 Location

The location of auditor's report within an annual report varies. In total, 94% of auditor's reports were included before the financial statements. Only 6% of reports were located after the financial statements, though this did increase to 13% for auditor's reports issued for FTSE 100 companies.

There are also different approaches into how the auditor's report is integrated into the annual report (Figure 1). Most auditor's reports were included alongside the financial statements. A significant minority of companies (15%) include the report within the Governance Statement. A smaller proportion of reports (3%) are included as a separate document between the Governance Statement and the financial statements.

Fig. 1: Location of the auditor's report



2 Opinions

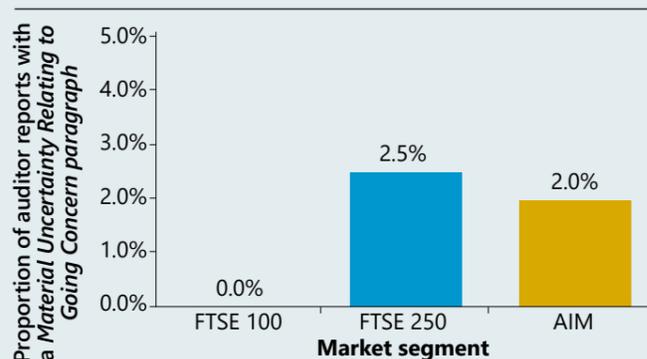
Audit opinions and other reporting requirements are similar for all the companies in the sample. Other than the important conclusion on the truth and fairness of the financial statements, narrative disclosures within the auditor's report provide the principle means for conveying useful information to users.

All of the auditor reports examined within the sample returned a 'clean' opinion, with no modifications or qualifications.

Very few reports included a 'Material Uncertainty Relating to Going Concern' (MURGC) paragraph (Figure 2). Only 2% of reports included this paragraph, which signals to users that there are events or conditions which may cast significant doubt on a company's ability to continue as a going concern. None of these were FTSE 100 companies. See Snapshot 5 for further information on going concern reporting.

Instances of other forms of reporting permitted by the auditing standards or required by company law were very rare. Only one 'emphasis of matter' paragraph was present in the entire sample. Additionally, auditors are required to report on certain matters under the Companies Act. These include information in the Strategic and Directors' Report, directors' remuneration disclosures, and the adequacy of accounting records. There was no instance of an auditor reporting anything substantive under these requirements in the entire sample.

Fig. 2: Prevalence of MURGC paragraphs



3 Length

The longest auditor's reports were issued for FTSE 100 companies, with a clear gradient to shorter reports for FTSE 250 and then AIM companies (Figure 3). A typical report for a FTSE 100 company was around 7,000 words long, compared to 4,500 for a large AIM company. In addition, auditor's reports issued by the Big 4 firms were consistently longer than those issued by Challenger firms.

A key driver of length is the number of Key Audit Matters (KAMs) included in each report (Figure 4). KAMs are matters that, in the professional judgement of the auditor, were of most significance during the audit. The numbers of reported KAMs vary considerably between different market segments. A typical FTSE 100 report will include 4 KAMs, 3 for the FTSE 250, and 2.9 for a large AIM company. Average numbers of KAMs have fallen since their introduction nearly 10 years ago, as comparisons with earlier FRC reports demonstrate.

There was also considerable variation in report lengths and numbers of KAMs for different industrial sectors (Figure 5). Banks and Energy companies – which are almost exclusively included in the FTSE 100 – have reports that are outliers from the norm both in terms of word counts as well as KAMs. For example, the auditor's report for Shell plc is over 19,000 words long and includes 9 KAMs, while the report for Barclays is over 13,000 words long and includes 6 KAMs. Financial Services companies have the shortest reports with fewest KAMs, as these entities are often investment funds and can be less complex. More information on KAMs in auditor's reports is provided in Snapshot 3.

The incremental impact of market segment and audit firm on report length can be estimated using statistical techniques (Figure 6). This waterfall diagram shows the changes need to move from an 'average' auditor's report with three KAMs issued by a Big 4 firm for a FTSE 100 company, to an 'average' report issued for a large AIM company by a Challenger firm with the same number of KAMs. The resulting AIM report is 64% of the length of the original FTSE 100 report. Of the total reduction in word count, 73% can be allocated to the change in market segment, while the change in audit firm accounts for 27% of the total reduction. This indicates that the market segment plays a more important role in determining the length of the auditor's report than whether the report was issued by a Big 4 or a Challenger firm.

Fig. 3: Auditor report length

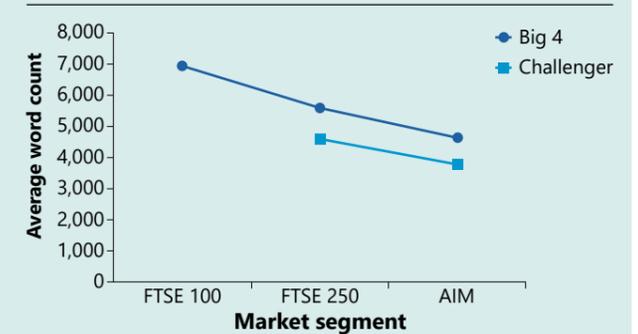


Fig. 4: Average numbers of KAMs



Fig. 5: KAMs by industrial classification

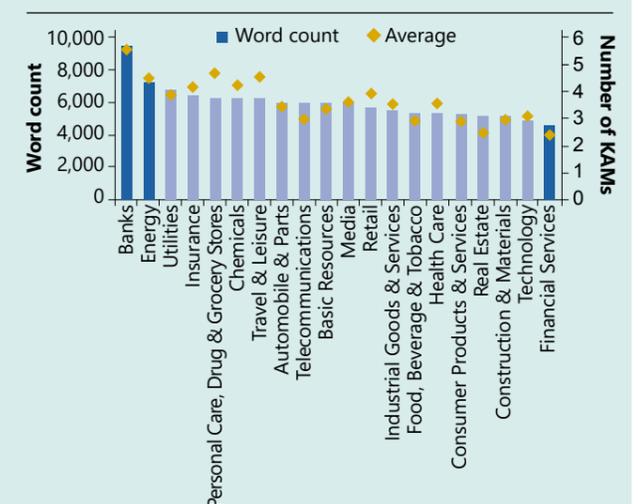
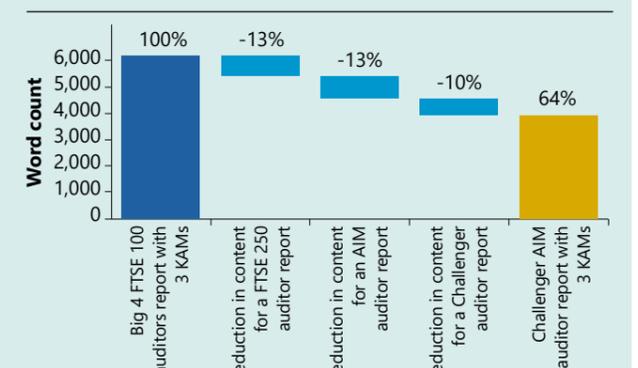


Fig. 6: Comparing FTSE 100 and AIM reports

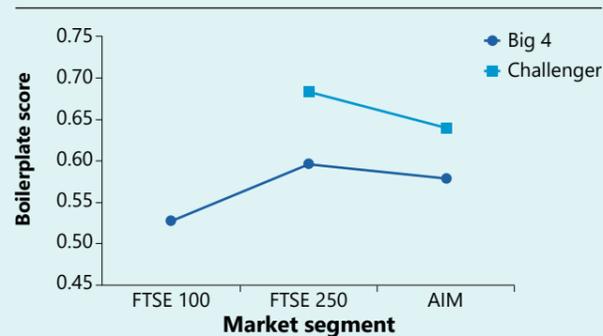


4 Boilerplate

A shorter auditor's report may result in less informative reporting, not only due to the reduction in information being provided to users, but also from the greater usage of standardised or generic language ('boilerplate'). Boilerplate disclosures may not help the user to understand the specific context and risk profile of a company. The evidence presented here suggests that shorter reports contain proportionately more boilerplate.

Figure 7 shows how average boilerplate scores vary across FTSE 350 and large AIM companies, and between Big 4 and Challenger firms. Each report is allocated a boilerplate score, which has been calculated as the proportion of the report that comprises common four-word phrase groups occurring in the sampled auditor's reports. A higher score indicates a greater prevalence of boilerplate.

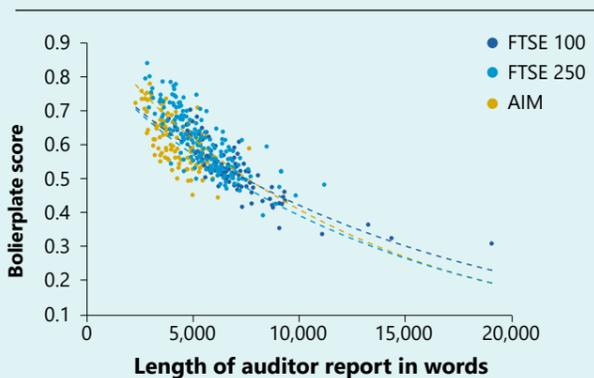
Fig. 7: Boilerplate in auditor reports



Challenger firms have consistently higher boilerplate scores across the two market segments where direct comparison with the Big 4 is possible. This could be because more companies audited by Challengers are smaller, less complex, and with a lower need for tailored reporting. In addition, this figure shows that auditor's reports issued for FTSE 100 companies have, on average, less boilerplate than reports issued for AIM or FTSE 250 companies. Average boilerplate scores are also higher for FTSE 250 companies compared to large AIM companies, regardless of whether the auditor's report was issued by a Big 4 or a Challenger firm. This may be due to the presence of standardised disclosures included in auditor's reports for companies listed on the Main Market of the London Stock Exchange.

The greater average length but lower boilerplate scores for FTSE 100 auditor's reports suggests that there is a relationship between the extent of boilerplate and the length of the report, and **Figure 8** confirms this to be the case. There is an inverse relationship between boilerplate scores and report length which is apparent across all three sectors. The relationship is not linear, and the boilerplate score does not fall below 0.3 even for lengthy reports. This suggests that there is a certain volume of boilerplate that is always included within auditor's reports. This is not surprising, as the auditing standards require certain prescribed language and statements to be made.

Fig. 8: Boilerplate and report length



There is limited variation in boilerplate scores between different market sectors. The two main outliers were banks and financial services companies. The former had an average score of 0.45, while the latter achieved a score of 0.65. These two examples illustrate the relationship between report length and boilerplate, since these two industrial sectors had the longest and shortest average report lengths.



Financial Reporting Council



Acknowledgements

This snapshot is based on an analysis of 396 auditor's reports issued during 2021, and commissioned by the FRC from a team of academics based at the Universities of Portsmouth, Southampton, and Brunel.

5 Readability

Useability is also enhanced by readability, and the auditing standards require the 'auditor's report to be in clear and unambiguous language'. Objective measures of readability decline for the sampled auditor's reports as reports lengthen and address more complex companies.

A proxy measure for the underlying clarity of language is provided by readability measures. These provide an indication of the level of education required to understand a text. Here, the Gunning-Fog index has been used to analyse the readability of auditor's reports. This measure indicates the number of years of formal education needed to read and understand a text, with a lower value for the index indicating that the text is 'easier' to read.

Figure 9 shows that there is an increase in readability for the auditor's reports in the FTSE 250 and large AIM segments for both Big 4 and Challenger reports. These reports are also shorter and contain more boilerplate. A greater prevalence of boilerplate makes a report easier to read but will provide less useful information for users. Differences between the two groups of audit firms is less clear-cut. Reports issued by the Big 4 are on average more readable (using the proxy measure) than those issued by Challengers for large AIM companies, the converse being true for FTSE 250 reports.

There were also differences in readability between market sectors (**Figure 10**). Longer auditor's reports addressing more technical subject matter are 'harder' to read, while shorter reports for companies with less inherent complexity are easier for users to consume. For example, auditor's reports for insurance companies were the 'hardest' to read, and reports for banks and energy companies also achieved high scores.

Fig. 9: Readability in auditor reports

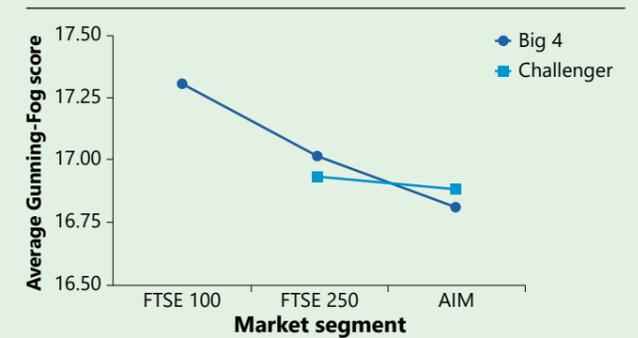
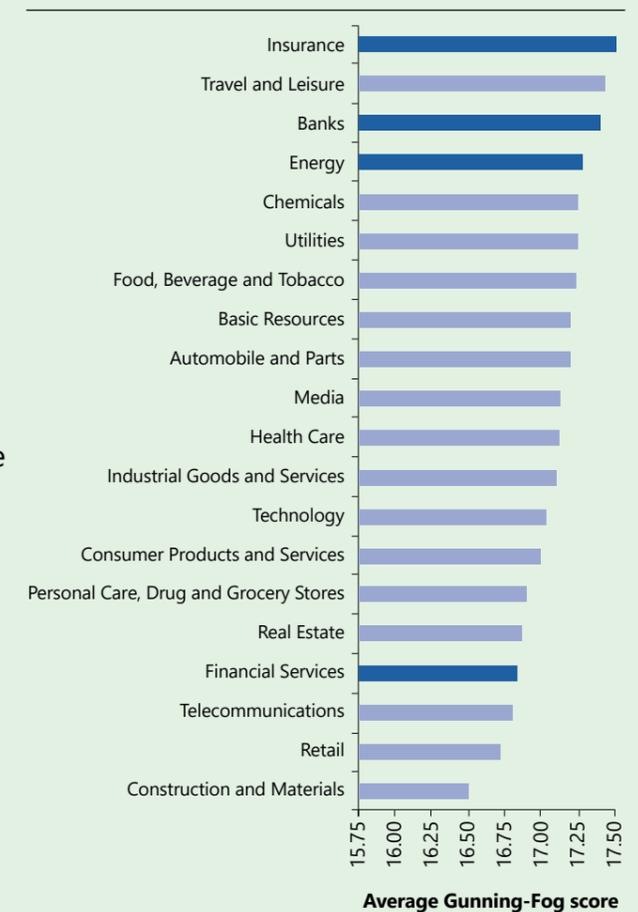


Fig. 10: Readability by industrial classification



Summary

- The **location** of the auditor's report with a company's annual report varies.
- The surveyed auditor's reports do not include any modified opinions, and nothing was reported by exception for matters required by law or regulation. This means that **narrative disclosures** were the key channel for the auditor to communicate specific findings for the audited company.
- **Report length**, and therefore the amount of narrative disclosure, is shortest for AIM companies, and longest for FTSE 100 companies.
- There are a small number of **unusually long auditor reports** which are not representative of general practice.
- **Boilerplate** is most prevalent in shorter auditor reports, and in reports issued by Challenger firms.
- Proxy measures of **readability** show that longer reports on more complex companies and with less boilerplate can be harder to read.