

Firm-level Audit Quality Indicators

Summary

We believe that further evidence needs to be provided of the potential benefit of the proposed AQIs to stakeholders, before the introduction of a mandatory set of AQIs requiring disclosure by firms. The recent AQI pilot with clients appeared to show that ACCs are interested in client specific AQIs that directly impact audit quality at the engagement level, rather than the firm level. This should be explored further to ensure that the proposed firm-level AQIs in the consultation document actually do reflect the requirements of all stakeholders, especially ACCs. In doing this, it would be important for the FRC to identify, for example, stakeholder decisions which would be impacted by the provision of firm-level AQIs.

Further consideration should be given to the impact of including a comparison of AQIs in a league table of firms. Whilst the provision of narrative may be helpful, there is a risk that stakeholders will pay little attention to the narrative and simply use the table of AQI scores to determine which firm to appoint as auditor, irrespective of differentiating factors such as portfolio mix or risk profile of the different firms.

Furthermore, could the provision of a table of rankings form a conflict with open market competition? For example, a comparison of staff attrition rates may make it more difficult for those firms with the highest AQIs to recruit, even though this may simply reflect the cyclical nature of market activity. Would this data also inadvertently create an even bigger gap between the largest firms and challenger firms? We would like to see a more detailed consideration not only of the benefits of including a comparison table, but also of the risks associated with this.

Question 1. Do you agree that the firms reporting their AQIs should be aligned to the scope of the revised 2022 Audit Firm Governance Code? If not, what scope would you prefer and why?

In principle, we agree that for simplicity and consistency, the firms reporting AQIs should be aligned to the scope of the revised 2022 Audit Firm Governance Code. However, there are alternate points of view which should be considered to align closer with stakeholder interest and also the public interest. From a market perspective, firms that audit the greatest number of entities in the PIE population are likely to be of most interest to stakeholders. Thus, an alternative scope would be to require those firms which audit 10% or more of the PIE population to report the proposed AQIs. Another way of considering this, would be to require only the Tier 1 firms under FRC supervision to report the proposed AQIs, on the assumption that these firms will be those that audit the majority of PIEs.

Until the guidance note providing definitions to aid consistency is prepared, it is not possible to determine accurately the impact that the introduction of mandatory AQIs will have on each firm within scope. However, based on the proposed AQIs included in the consultation document, to minimize the impact on engagement teams, a systems-based solution will be required. As noted in the consultation document, in 2020 the largest four firms were statutory auditors for 94% of the FTSE350 and each audited other PIEs as well. These firms are most likely to already have the most advanced systems in place; for the other firms, this will be to a lesser extent. This will require an investment in time and money for some firms to be able to report the required AQIs. While a manual solution can be developed, there will also be a disproportionate ongoing cost associated with this and potential disruption to engagement teams, as well as the inherent risk associated with manually preparing data.

Accordingly and subject to our summary comments, we propose that initially, only the largest firms be required to undertake mandatory reporting of AQIs, commencing April 2023 with reporting in 2024. This would be a similar approach taken to the voluntary adoption of operational separation by the largest UK firms. This should be followed by a post implementation review period to assess the value and impact of AQIs reported and allow, where necessary, for guidance and AQI definitions to be refined, before requiring other firms to comply with the requirements. This will allow the other firms time to develop the necessary systems-based solutions and ensure that the required funding for these changes has been procured. Where systems-based solutions cannot be readily obtained within a reasonable cost and timeframe, firms should be exempt from disclosure of those impacted AQIs.

Question 2. Do you agree that the AQIs should include all audit engagements, but segmented between PIE and non-PIE audits? If not, which engagements do you think should be included?

It is difficult to see how reporting AQIs for non-PIE audits is in the public interest. We question whether stakeholders in non-PIE entities will be sufficiently interested to warrant the time and cost of preparing segmented AQI information.

Further, as noted in the consultation document, investors and ACCs were not always aware that AQIs are reported in firms' Transparency Reports; it would be helpful to understand the benefits that stakeholders have obtained from the publication of Transparency Reports and the AQIs already provided by the PRG firms. The FRC may wish to align their decisions on firm-level AQIs with further improvements in the usefulness and value of AQIs already reported in Transparency Reports.

The nature of the proposed AQIs set out in the consultation document is such that some would provide the most benefit from relating only to PIEs (for example, AQI number 6 Inspection results – internal), whilst others cannot be segmented as proposed (for example, AQI number 1 'Staff/culture survey results', AQI number 9a 'Staff utilization, AQI number 10 Staff attrition and AQI number 13 Training), as audit team members are likely to work on both PIE and non-PIE audits. Thus, we recommend that the AQIs as presented should be individually designated as requiring disclosure of the total for the firm or for the PIE audit population only.

We do not support the proposed approach of providing information for each AQI segmented between PIE audits and non-PIE audits.

Question 3. Do you expect any additional costs to be incurred by firms reporting over a period which is not aligned with their financial years? Are there ways to minimize these costs?

Reporting to a 31 March period end is unlikely to add significant additional cost beyond reporting to our financial period, although as noted earlier, costs will need to be incurred to develop systems-based solutions for a number of AQIs and it is expected that these will not be insubstantial. However, we suggest that 30 June would be a better reporting date, as it is likely to include the most recent data relating to PIEs (assuming predominantly December and March year ends) and also result in data collation and presentation being outside of the traditional 'busy season' for many audit firms.

Question 4. Do you agree that it would be useful to include supporting narrative? Please provide suggestions to ensure that the information is concise and useful for users of audit services.

It is essential that supporting narrative is included to provide users with specific contextual information. Because of the differing nature of the client base of the firms proposed to be in scope for mandatory AQI reporting, without detailed narrative, the reader will only have a quantitative comparison between firms that could be misleading and result in sub-optimal decisions on auditor appointment being made, for example. Furthermore, it will potentially be misleading to compare a PIE audit AQI between the large firms and other firms, as complexity of PIE audits may differ between each firms' portfolio, which cannot be explained without detailed narrative.

Accordingly, we are reluctant to apply a maximum word count to supporting narrative, as some AQIs might require little explanation, whereas others may require considerably more. A post-implementation review after 2-4 years should be performed, to aid refinement of issues such as the extent of supporting contextual information.

Question 5. Do you agree with our proposed AQIs? If not, or in addition, do you prefer some of the alternatives presented above? Please explain, using reference numbers.

We are broadly in agreement with the 'proposed' AQIs and make the following specific comments:

AQI 1 Staff/culture survey results

Is there an expectation that the annual survey will be undertaken at a specific point in time, to align with the reporting period of the 12 months to 31 March? We believe that each firm should be able to choose the timing of the annual survey as it can provide important information in advance of the 'busy season' commencing and allow any enabling actions to be undertaken. Furthermore, to ensure consistency, do the FRC propose to specify the exact wording to be used by all firms in the staff survey?

AQI 2 Audit planning milestones

We believe that this AQI needs to be more clearly defined. The proposed indicator refers to the 'target completion date'. Is there an expectation that each firm has the same 'target completion date' or can this be for each firm to determine, reflecting the differing portfolios and requirements of each firm? We recommend that the completion of the audit planning phase should be the only milestone measured, to provide simplicity and reduce the burden of data collection.

AQI 9a Staff utilisation

The description refers to the 'number of hours worked per week'; is there an expectation that weekly utilisation data is presented? We believe that annual utilisation data should be disclosed and that the following grading groups should be used: Engagement leaders (partners and directors), managers (of all grades) and others.

AQI 10 Staff attrition

Is the expectation that the data for this AQI will cover the 12 month period to 31 March each year? If so, it is likely that this information will be of limited use as it will be mostly out of date by the time it is published. It may be more meaningfully to present this data on a quarterly basis, to provide greater insight. There also needs to be a clear definition of which people are included in this AQI; for example, will this include non-fee earners, audit and accounting technical teams etc?

AQI 14 Diversity and inclusion

The description for this AQI refers to gender and ethnic diversity. We believe that diversity and inclusion is broader than this and the definition should be extended beyond the visible, to include areas such as social mobility, to provide greater insight to stakeholders.

In summary, we believe that the AQIs should be limited to those that are designated as 'proposed'; those marked as 'alternatives/additions' are likely to be highly variable depending on the nature of each firms' portfolio and hence will be of less value to the reader.

Question 6. Do you think there are any other firm-level AQIs that we should consider? If so, please explain. (If relevant, please refer to the list of AQIs we have considered but not proposed, in Appendix 1.)

There are no other firm-level AQIs that should be considered.

Question 7. Are there any other comments you wish to make about these proposals, including concerning costs, benefits, or impacts not discussed above?

No other comments