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Dear Shamima

Firm-level Audit Quality Indicators: Consultation

We welcome the opportunity to comment on this Consultation. Audit Quality Indicators (“AQIs”) have the potential to enhance both audit quality and the financial reporting ecosystem more generally and as such we support this proposed development. However, we consider that care will be needed to ensure that all users of AQIs have a clear understanding of how they can be used effectively. As noted in the consultation, AQIs are not mechanistically related to quality, and it should not be presumed that there is an ‘optimal’ or ‘target’ value for most AQIs. In order for the use of AQIs to be effective, users must be educated around these inherent limitations and be willing to use supporting narrative and dialogue to understand how AQIs interact with the nature and risk profile of a specific audit firm’s portfolio of audits. It will not be beneficial for audit quality if the reaction to published AQIs is to drive audit firms to ‘race to the middle’ of published AQIs on the basis that being seen to be in the pack is the safe outcome.

In order to fully conclude on the relevance of the proposed AQIs we are of the view that further consideration is given to the potential needs of users, and indeed the nature of expected users of this AQI information. A number of comments in the consultation point to expected users being linked to Public Interest Entities (“PIE”) audits which would suggest that the published AQIs could sensibly be focused on PIE audits alone. However, other comments focus on the firm-wide nature of the target AQIs indicating that all firm information is most relevant. In practice we believe that intended and actual users of published AQIs will be most interested in information aligned with PIE audits.

It is inevitable that users will seek to make comparisons using the AQI data provided. Indeed, this is recognised in the executive summary of the consultation as a key purpose for publishing such information. Users will seek to make comparison across

firms, to compare the trends of individual firms over time and to compare individual audits with firm-level data.

Users will also want guidance on ‘what does good look like’ in interpreting the data and when does the data indicate potential audit quality issues or concerns.

It is also important that users understand that there is currently no direct link between these, or any other AQIs, that predict audit quality outcomes. Adverse trends in these AQIs may indicate an increased risk around audit quality but it is the audit firms’, and audit team’s response to these trends that is the best indicator of likely audit quality. We encourage production of guidance around how to consider published AQIs that focuses on explaining the factors that would impact the AQIs of individual firms. This will aid users to have effective dialogue with audit firms, but will also clarify that AQIs for individual firms will and should differ based on portfolio risk profiles and business models. Whilst some of the proposed AQIs may facilitate comparison across firms, there are some where interpreting comparative data will be more complex and less informative due to the individual operating models and audit portfolios of individual firms. We believe the FRC has a key role in educating users about the benefits and risks of comparison.

However, it should be recognised that audit firms and audit Responsible Individuals (“RIs”) will only be able to comment on the information provided about their own firm and provide comments about firm-level trends and how individual engagement level AQIs may compare with firm wide averages. Individual firms will have limited ability to comment on differences between their AQIs and those of other firms. As such we anticipate much of the conversation between auditors and audit committees/those charged with governance, will focus on the comparison of engagement level AQIs over time and with own firm-level AQIs. This will enable auditors to illustrate how the processes, controls and governance at an audit entity and the assessed risks and complexities within an individual audit influence the resources deployed on a given audit. Through this discussion, AQIs may have a role in triggering improvements in the financial reporting ecosystem. This is because the discussion about the comparison of engagement level AQIs to firm level AQIs may illustrate to management and audit committees the impact of heightened entity level risk features on audit resource requirements. This in turn may trigger actions by the audited entity to address these factors.

We note, and support, the reference in the executive summary to the objective of providing information to other users of audit services and in response to frequent requests from stakeholders. We would ask the FRC to use publication of AQIs as a means to encourage investors to increase their engagement with audit committees and audit firms as this will create an opportunity for dialogue that should enhance the overall financial reporting ecosystem.

It is almost impossible for two individuals to discuss AQIs without getting rapidly drawn into a debate about definitions. This is another area where clear guidance from the

FRC will be critical to the success of the use of AQIs. We have recommended that the FRC convene roundtable style discussions with audit firms, audit committees and other stakeholders over the definition of individual AQIs to aid implementation of this proposal.

We are also concerned about the costs involved with what is essentially a requirement to create a second monitoring cycle for a number of key firm processes. Given the AQI information is by design high level and aggregated, and firms will not be able to provide any meaningful commentary on cross firm comparison, we question the need for all audit firms to operate their process to the same reporting cycle. We operate with sophisticated financial markets where experienced users are able to compare the results and performance of entities operating with differing year ends. We consider that users of AQIs will be equally capable of dealing with information prepared to different period end dates.

We respond to the individual questions as follows:

Q1: 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?

We agree with this proposal. It is important that Boards and audit committees making decisions over the selection of auditors have access to information about potential auditors. Whilst we support the FRC taking a lead on the publication of AQIs, we encourage an international discussion about the use and publication of AQIs to aid consistency and avoid the duplication of effort.

Q2: 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?

As discussed in our introductory comments, this depends on the intended purpose and expected users of published AQIs. The majority of the narrative in the consultation focuses on users that are most closely aligned with the audit of PIEs, as such, we consider the most appropriate information to publish covers, where possible, only PIE audits. We recognise that for some AQIs this may not be possible in which case we consider that firm level AQIs should be published using a range of inherently judgemental assumptions.

As an illustration of the potential challenges to address, we anticipate that across firms, auditors, especially more junior team members, may work across PIE and non-PIE audits. As a result, indicators such as culture survey results, staff attrition and utilisation could only be split in this manner using assumptions that would likely lead to inconsistency across audit firms. In addition, as many firms develop centres of excellence or other shared services focused on individual audit procedures, it may become increasingly difficult to split these activities across PIE and non-PIE audits. As

such these are examples of AQIs that might be most appropriately presented on a combined PIE/non-PIE basis. However, AQIs such as RI hours and quality inspection results can be identified for PIE audits and their separate publication would be relevant to the identified likely users.

We have provided some further comments on whether we consider the proposed AQIs could be presented for PIEs only in our response to question 5.

Q3: 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 minimise these costs?

We anticipate that there will be potentially significant additional costs arising from this proposed approach. Any incremental data collection process requires a level of governance and review that adds cost and there are certain of these AQIs where new processes may be required to prepare information at a new reporting date. We note the proposed requirement for senior partner attestation of the information provided – this further increases the formality of governance that will be required.

Whilst we recognise that the AQIs being considered in this consultation represent only a subset of the matters considered by ISQM1, we believe that all firms are anticipating significantly higher costs to support the attestation expectations of that standard. We believe that the attestation requirement within these proposals will add proportionately to costs. We would request that the FRC considers whether, given the attestation requirements embedded within ISQM1, a separate attestation process over AQIs is required. We would also request that, if it is concluded that separate attestation is required, consideration is given to introducing flexibility over who provides the attestation to allow processes to be aligned with that being adopted for ISQM1 purposes.

It may be possible to reduce data collection and validation costs over time through investment in aligning internal systems and procedures with these reporting requirements but this itself will require initial investment. For many firms, these requirements may also be difficult to implement if it requires amending systems developed and maintained by international networks rather than the individual UK member firm.

Firms currently include AQIs in their transparency report based on the most recently available information that is generated from processes that are aligned with the firm's existing reporting cycle. Practical matters, where guidance would be required, such as whether surveys conducted to align with firm's reporting year would need to be repeated to provide information closer to a 31 March reporting date – to do so would duplicate effort, in many cases, the existing survey will be performed to meet commitments to the firm's global network. Another, more significant impact could be to the firm's internal quality monitoring process. It would appear there is an expectation

that these are either realigned to a 31 March year end or that data collection is split so that a 31 March year disclosure may comprise information related to part of two annual cycles of reviews. It is likely that firms will find it difficult rephase major monitoring programmes and hence could be required to provide information drawn from two cycles of reviews. It is noted that, at present, AQR reports comprise details for the most recently available reporting cycle.

Q4: 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?

We believe that supporting narrative will be key to the user's understanding of firm level AQI trends. As noted in our opening remarks, we also anticipate that users will want to understand the differences in reported information across audit firms – we anticipate that this will be an area of difficulty and complexity which is likely to add time and costs to the audit process and audit tendering. This is probably an inevitable consequence of providing comparable information in this manner.

We agree with the principle that, to be beneficial to readers, explanations should, in the main, be concise. As such, we agree with the proposal of using a word limit guide or similar constraint on the extent of supporting narrative. We do, however, believe that there may be some situations where a more expansive response is required and consider that any reporting tool should have some level of flexibility to accommodate this scenario. In addition, we also suggest that users of this information are encouraged to also consider the more detailed commentary on audit quality contained within each firm's Transparency Report ("TR") given this user group are a key part of the intended audience of the TR.

We would suggest that the FRC provides easily accessible guidance for users on the definitions used to determine each AQI. Firms will be more easily able to limit their commentary if there is a clear articulation of the purpose and definition of each AQI readily available to users.

Q5: Do you agree with our proposed AQIs? If not, or in addition, do you prefer some of the alternatives presented above? Please explain, the reference numbers.

We have considered each of the proposed AQIs and alternative AQIs in Appendix 1 and Appendix 2 to this response, respectively. Our overarching comments are:

- i) Much of our internal debate about this consultation focused on definitions and the impact of small definitional changes on the ease of data collection. We therefore recommend that the FRC undertakes roundtables or other outreach to obtain input from audit firms into the potential definitions of individual AQIs to aid the implementation process. We have provided some comments, for illustration, on practical application issues in this response.

- ii) Overall, we consider that the proposed AQIs are relevant but have reservations about some, mostly linked to the need for greater clarity about implementation and definitions. Our strongest reservation is with AQI 4, Internal quality review hours, which we consider reflects only a small proportion of quality monitoring effort and appears to give no recognition to firms that have invested in preventative 'hot' file monitoring activities alongside detective 'cold' file reviews.
- iii) We are also concerned about the number of AQIs proposed. Although ten separate AQIs are proposed, which appears to us to be a suitable number we note that many could be interpreted as contained more than one AQI. For example, if PIE/non-PIE and all audit information is separately presented that would substantially increase the volume of data provided. Equally, it is not clear whether the proposal is for one external AQI combining AQR, QAD and, where relevant PCAOB findings, if these would be separately provided or whether it is anticipated that the survey results linked to proposed AQIs would be presented as a single or multiple data points.

Q6: Do you think there are any other firm-level AQIs that we should consider? If so, please explain.

We have reviewed the list of firm-level AQIs considered but not proposed as set out in Appendix 1 to the consultation and agree that these are not appropriate firm-level AQIs. A number are best suited to consideration at the engagement level whilst others, we consider as part of a root cause analysis process, but do not believe are appropriate AQIs more generally.

Whilst we agree there is no requirement for a separate AQI in relation to offshore delivery centres, consideration should be given to how such individuals and hours are reflected within the proposed AQIs. For example, is it appropriate to include or exclude a team of individuals operating in a centre of excellence for processing bank confirmations based on their location? Does the answer change if that team provides services only to the UK firm within the network or multiple firms?

In our response to question 5 we have questioned whether there is merit in including the results of internal and external firm-level quality monitoring activity alongside the results of 'cold' file review processes (proposed AQIs 5 and 6).

Q7: Are there any other comments you wish to make about these proposals, including concerning costs, benefits or impacts not discussed above?

There are no specific questions in the consultation about the timetable for introducing these requirements, but we consider there are significant matters to consider in relation to timetables. As previously commented in this response, we agree with the issue of consistency, but without the detailed definition of each proposed AQI we cannot determine how difficult it will be to capture the relevant information for each proposed item.



We also have included some comments in our introductory remarks that are relevant to this question about the potential benefits that could arise from these proposals.

In conclusion, we are supportive of the principle and many elements of the proposals set out in the consultation and believe that they can be used to enhance the debate about audit quality. However, we believe it is critical to ensure that there is alignment around definitions of AQIs and the understanding of their purpose and applicability amongst auditors, audit committees, management and other users.

Perhaps more importantly, we believe that effective use of these AQIs with appropriate understanding and context could generate good dialogue between investors, audit committees and auditors leading to enhanced understanding of, and response to, the impact of entity-level risk, governance and control on audit delivery. If this can be achieved, there will be resulting improvements to the financial reporting ecosystem. If this opportunity is lost, there will be further cost incurred by the auditing profession, with limited resulting benefit from publication of this information.

Please contact me if you would like to discuss this further.

Yours sincerely,

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Appendix 1

We comment on the proposed AQIs:

1. Staff / culture survey results

We consider there are relevant AQIs that can be measured in these surveys but believe it is difficult to identify a single question that encapsulates all aspects of audit quality. We are assuming that, in order to deliver consistency, the intention would be for the FRC to define relevant questions and the response scale to be used. Whilst this would support consistency, it will create significant implementation issues for firms that use a globally developed platform for such surveys to provide network comparable information. In addition, timing may be an issue for firm's where there is an established timetable for such surveys that is aligned with the firm's year end. Duplication of surveys asking similar questions also risks survey fatigue that impacts the reliability of responses provided. This is an example of an AQI which would be difficult to capture responses split between PIE and non-PIE audit unless all audit RIs and staff, including those in support and consultation roles, are assigned into these two categories.

2. Audit planning milestones

We agree that effective audit planning is a key element of audit quality and hence that this is a suitable area for an AQI. However, we have concerns of unintended consequences for AQIs of this type. For example, creating an environment where failure to meet a pre-determined planning milestone is considered an adverse outcome puts considerable pressure on engagement teams to meet that deadline. Root cause analysis has shown us that too great a focus on a deadline is, in fact, counterproductive to audit quality and creates a risk teams may rush to meet an imposed deadline. We have sought to create a culture where teams request extensions to such milestones and the overall audit timetables are re-appraised as a result. This introduces a level of additional monitoring and oversight which will add complexity to firm-level data collection, but we believe delivers a more effective engagement level quality control outcome. We would therefore recommend that the definition of this AQI is carefully considered to ensure that there is no unintended downstream consequence for audit quality.

This is an example of an AQI that can be more meaningfully measured across PIE audits. It is far easier to determine consistent target milestones for listed entity audits that operate, in very broad terms, to similar timetables. For non-PIE audits, the range of audit timetables is so broad that pre-set milestones for completion of planning work across this population of audits can only ever be indicative. For these engagements the use of engagement specific milestones is far more effective, but this does have consequences when seeking to aggregate performance across a broad range of audits. As such we consider this AQI, whilst very valuable at the engagement level, has little relevance on non-PIE audits when presented in aggregate across a large volume of varied audits.

4. Internal quality review

We agree that investment in a suite of internal quality monitoring measures could be an appropriate AQI. However, we have concerns over this specific definition. As defined,

this appears to cover only the time spent in the annual engagement closed 'cold' file review process. Firm's also commit significant time and effort in firm level monitoring of compliance with quality control procedures and this will further increase with implementation of ISQM1. In addition, many firm's have invested in preventative 'hot' file quality control programmes focused on engagements before the audit report is delivered, which go beyond the review activities of the engagement team and engagement quality control reviewer. It would seem to us to be inappropriate for those firms that have invested in 'hot' file monitoring and firm wide oversight to appear less invested in audit quality activities than those with expanded 'cold' monitoring processes. We consider that a more balanced AQI would be a measure that reflects this wider range of internal quality control programmes.

This is also perhaps a good example of the challenge around the precision of definition. For example, does it cover time spend by the engagement team responding to questions during the inspection process, time spent managing the overall inspection programme, and time invested in root cause analysis, remediation and training?

5. Inspection results – external

We agree that this is a well-recognised AQI that should be included within this analysis. We presume that a 31 March reporting date has been selected in part to align with the annual AQR cycle of reviews but question whether, given these results are now typically published in July, does this either delay the release of AQIs or accelerate the timetable for publication of AQR results. As a point of practicality, the PCAOB does not provide engagement file gradings, so there will need to be both clarity and regulatory agreement as to how PCAOB findings are included. This AQI can be presented separately for PIE audits.

However, given the focus of this consultation is firm-wide AQIs, we believe consideration should be given to content of the firm-wide findings included in each firm's AQR report. Whilst we recognise that not all firms reporting AQIs may be subject to AQR inspection each year and the focus of the inspection changes from year to year, we consider that this firm-wide information is relevant and could be considered for inclusion as an AQI.

6. Inspection results – internal

We agree that this is an appropriate AQI but note that the use of a March end point means that for many firms they will either need to change the timing of their internal process to align with this date, report results in arrears (as is done currently in the published AQR results) or introduce additional cut-off points within their existing inspection cycles. The internal inspection process is often aligned with global processes and performance management activities linked to the network's year end date. For example, for global consistency across our network our internal inspection processes are aligned with our 30 September year end and performance management cycles. This AQI could be presented separately for PIE audits.

As with AQI 5 above, we also suggest there should be some recognition of the findings of the firms ISQM1 control testing given the importance of this at the firm level and the significant investment being made by all firms in relation to implementing these requirements.

8. Partner involvement in audits

We agree that this could be an appropriate AQI but again recommend that care is taken in defining the definition of the AQI. For example, the proposed indicator makes reference to engagement partners and key audit partners which could indicate the intention is to present this information including the role of key audit partners operating as a component audit partner within a group audit. If this is the intention, is it also intended to capture the hours on component audits (total and key audit partners) performed by other auditors outside of the UK audit firm? If so, this is potentially a significant additional data collection activity as, whilst it is routinely collected by most group audit teams, it may not be collected on an aggregate basis across UK audit firms and subject to the necessary completeness and accuracy checks that would be needed if it were to be publicly reported.

In addition, there is no mention of individuals acting in the role of Key Partners Involved in the Engagement and the leaders of the teams representing auditor's specialists and experts who also have a key role in the delivery of high-quality audits. On larger audits these individuals are a critical element of audit quality and to exclude such hours would seem inappropriate given the reason for their involvement in the audit in the first place. We agree that this AQI could beneficially be presented separately for PIE and non-PIE audits.

This AQI could be presented separately for PIE audits.

9. Staff utilisation

We agree that this is an appropriate AQI. Again, care will need to be taken around definitions and whether the utilisation rates for service centres, technical departments and offshore delivery centres are included in the analysis. In addition, whilst this is an indicator that we anticipate all firms will currently use, we suspect the basis of calculation across firms will vary.

In theory this appears to be an appropriate AQI to split between PIE and non-PIE audit teams but in practice this may be difficult to determine without the use of broad assumptions. We suspect that, even in firms that have broadly split into PIE/non-PIE audit teams, there will be significant numbers of individuals who, due to their roles, routinely work across PIE and non-PIE audits and many more who are moved, on a controlled basis, between these groups to manage delivery volumes. As a result, we question whether this analysis may be best presented on an aggregate basis to avoid the inclusion of allocation assumptions that are likely to be inconsistent across firms. We are less certain of the benefits to the publication of 'busy season' information. We believe that most firms have taken actions to spread audit activity away from the peak

February to April reporting season and as such the workload peak in the January to March period is potentially less marked than historically seen.

10. Staff attrition

This AQI has the benefit of direct comparison across firms if consistently calculated and, on this basis, we cautiously support inclusion of this AQI. Attrition levels could impact audit quality on the basis that individuals who are leaving may be less committed or motivated to deliver audit quality and the loss of experienced individuals must reduce capacity and competence. However, as an AQI it does not reflect any of the safeguards that are put in place by firms to respond to attrition level. As such, it potentially provides a measure of the quality challenge the firm is facing from attrition levels but gives no recognition of the firm's response to attrition. For example, it gives no recognition to recruitment levels, overall staffing levels, management of the timing of audit work and timetable delays, investment in data and analytics tools and delivery centres or management of the overall book of work. Again, this AQI would also be difficult to present on a PIE/non-PIE basis.

As an alternative we suggest consideration is given to Partner/staff and manager/staff ratios as a potential alternative AQI (AQI 12).

13. Training

We agree this is an appropriate AQI. We agree with the comment in the consultation 'The type, quality and relevance of the training are also important considerations' and recommend that the types of qualifying training are carefully defined to support comparability. Again, unless firms have all auditors fully segregated between PIE and non-PIE audit, this AQI would be most meaningful at the all-audit level.

14. Diversity & inclusion

We agree that diversity and inclusion are an important AQI but question whether the focus should be only on gender and ethnicity. We also question whether it is appropriate to restrict the indicator to an assessment at the level of audit leadership, however that is defined.

Appendix 2

We comment on the Alternative AQIs:

3a/3b. Proportion of audit effort by audit phase

We consider that 3a is a relevant AQI at the engagement level and it is one that we consider as part of our root cause analysis process. Our experience is, however, that this AQI is not easily aggregated across populations as the overall approach to audits and their respective timelines is very varied.

We consider 3b is a less relevant AQI overall. There are many audits, including some lower risk PIE audits, where this percentage could justifiably be high whilst there are other audits where hindsight shows that the level of work done in the last two weeks was too great even though, as a percentage of total hours, the proportion of overall audit effort might appear low. As an individual engagement level metric, this is also difficult to use in practice given the proximity to the planned or actual signing date.

As such we consider 3a has greater use as an engagement level AQI than 3b but agree that neither measure are suitable firm level AQIs.

7. Involvement of EQCRs

We agree that this is a potential AQI but also agree with the conclusion that it is not a primary firm-level AQI. At an aggregate level, the percentage of total EQCR hours compared with total audit hours incurred represents an average across engagements of many different sizes and complexities which will produce a figure that is difficult to compare across firms due to the portfolio mix within individual audit firms. It will also create a potentially misleading benchmark for use by audit committees when challenging the proposed hours at an individual engagement level. This is a metric that could only be produced for those engagements where an EQCR is appointed but the data collection is potentially difficult due to time recording processes which may collate hours across all audit activity within a group whilst only a proportion of those hours relates to the engagement with EQCR involvement.

11. Use of specialists

We agree that this is a potential AQI but also agree with the conclusion that it is not a primary firm-level AQI. As with the role of EQCRs, the requirements for the involvement of auditor's specialists and experts varies significantly across engagements. Hence, any aggregate percentage figure is unlikely to provide meaningful analysis. This AQI is more relevant as an engagement level AQI.

12. Staff / partner and staff / manager ratios

This is a potentially important AQI at the firm level as it provides insight into the supervision capacity embedded within the audit firm's business model. We suggest this is considered as an alternative for the proposed Staff attrition AQI. Again, this may be an AQI that should be provided on an aggregate basis rather than split between PIE and non-PIEs audits.