Financial Reporting Council

TRANSPARENCY REPORTING

AQR THEMATIC REVIEW

SEPTEMBER 2019

WHAT IS TRANSPARENCY REPORTING?

Auditors have a crucial public interest role, providing assurance on the truth and fairness of information published in an entity's annual report and accounts. Given the importance of the audit to users of financial information, those users are entitled to understand how appropriate their auditor is for the role. This requires information on their auditor to be publicly available.

EU and UK law requires auditors of Public Interest Entities ("PIEs") to publish a transparency report that includes details of their:

- legal structure and ownership;
- governance structure;
- internal quality control systems; and
- quality assurance and independence practices.

The FRC's Audit Firm Governance Code ("AFGC" or the "Code") provides a benchmark of good governance practice against which firms can report. Its principle objectives are:

- to promote audit quality;
- to help the firm secure its reputation more broadly; and
- to reduce the risk of firm failure, which in relation to the largest firms would be of systemic significance.

The Code applies to accountancy firms that audit more than 20 entities listed on a regulated market and requires them to include additional information in their Transparency Report on matters such as:

- How the firm monitors its governance system and Key Performance Indicators ("KPIs") used;
- The appointment and focus areas of Independent Non-Executives ("INEs"); and
- An assessment of risks that would threaten the firm's business model, future performance, solvency and liquidity and how these risks are being managed.

This reporting should provide information that better enables stakeholders to assess the appropriateness of firms to undertake audits and to assist in holding the firm's leadership to account for key governance and performance matters.

The firms that are within the expressed scope of the Code and those that voluntarily adopt it, are listed on page 4.

REVIEW OBJECTIVE

The objective of our review is to assess the effectiveness of Transparency Reporting by audit firms in the UK. The scope of this thematic review includes all firms that prepare Transparency Reports, with the primary focus on those that adopt the AFGC. The reported findings therefore relate to firms that have adopted the AFGC only, unless stated otherwise. A table in section 2.2 provides details of the firms that prepare Transparency Reports in the UK and the relevant regulations.

Where a firm audits the accounts of one or more major local government or healthcare bodies, they must also comply with the Local Auditors (Transparency) Instrument 2015. We comment on this in section 3.3.

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The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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Executive Summary

1.1 Introduction

There is significant scrutiny of the audit profession in the UK. Recent corporate failures have left some users of financial information questioning whether auditing in its current form meets their needs and whether the audit opinions of firms conducting audits can be relied upon. There is also concern that insufficient competition in the audit market may be hindering much needed advancements in audit quality.

Against this backdrop, Transparency Reporting by the large accountancy firms that perform audits is more important than ever. The reports present an opportunity for the firms to:

- Provide relevant, reliable and useful information that facilitates engagement between firms and users of financial information;
- Communicate a balanced self-assessment of the challenges the firms face in relation to audit quality and the effectiveness of their actions to overcome them, including how the INEs at the firms have assessed this; and
- Promote confidence (where warranted) in their systems, processes and governance to engender public trust.

1.2 Key findings

Our review found that Transparency Reports are not being read by the intended beneficiaries, principally investors and Audit Committee Chairs and members. We have identified two key problems:

1) A lack of awareness amongst investors and Audit Committee Chairs that the reports exist; and
2) For those that are aware of the reports, a view that they are too long and overly positive to be useful. This is unsurprising given that many of the firms have seen the reports as a marketing opportunity rather than solely an accountability or compliance document.

On that basis, Transparency Reporting by the large accountancy firms that perform audits is not currently effective.

1.3 Next steps

Firms

The reports would be more useful if they were more balanced and explained more clearly the challenges and risks the firms face in seeking to deliver consistently high-quality audits, along with their assessment of how successful they are being at meeting those challenges. Such an assessment will help users of the reports assess whether the firm's latest actions are substantially different to those of the past and whether they can expect improved audit quality at that firm as a result. Sitting alongside the reports on audit quality that the FRC already publishes for the largest firms, Transparency Reports should help ensure that those with an interest in audit quality across the market, and those choosing auditors, have appropriate and balanced information.

FRC

The FRC will continue to promote comparability and usefulness of content across the firm's reports. Many firms have voluntarily adopted several Audit Quality Indicators ("AQIs") to help measure their audit quality and they report on these so users of financial information can make direct comparisons between the firms. As part of our planned thematic review on AQIs we will consider, along with key stakeholders, whether there are other comparable measures that should be reported within Transparency Reports. We believe that increasing the amount of factual and comparable information in Transparency Reports will make them more useful.

Audit committees, investors, and other users of Transparency Reports

The intended beneficiaries of the reports have an important role to play here as well. The reports are produced by the firms, they are generally readily available and yet they are often not being read or used. Whilst the current reports need to be improved, they still contain a considerable amount of useful information, and the firms put a great deal of effort into producing them. To change the reports for the better, we believe that more dialogue is needed between the firms and the key stakeholders. We will continue to push firms to disclose more useful information and to be more balanced, but at the same time other stakeholders need to provide the firms with a greater incentive to do so by reading, using and feeding back on the reports.

Having performed this review, we consider that, for the full benefits of Transparency Reporting to be realised, the existing requirements need to be rethought. We will begin work in 2020 to consider how this is done and, importantly, how any changes can complement the outcomes of the significant reviews of the audit market that are taking place at the moment.

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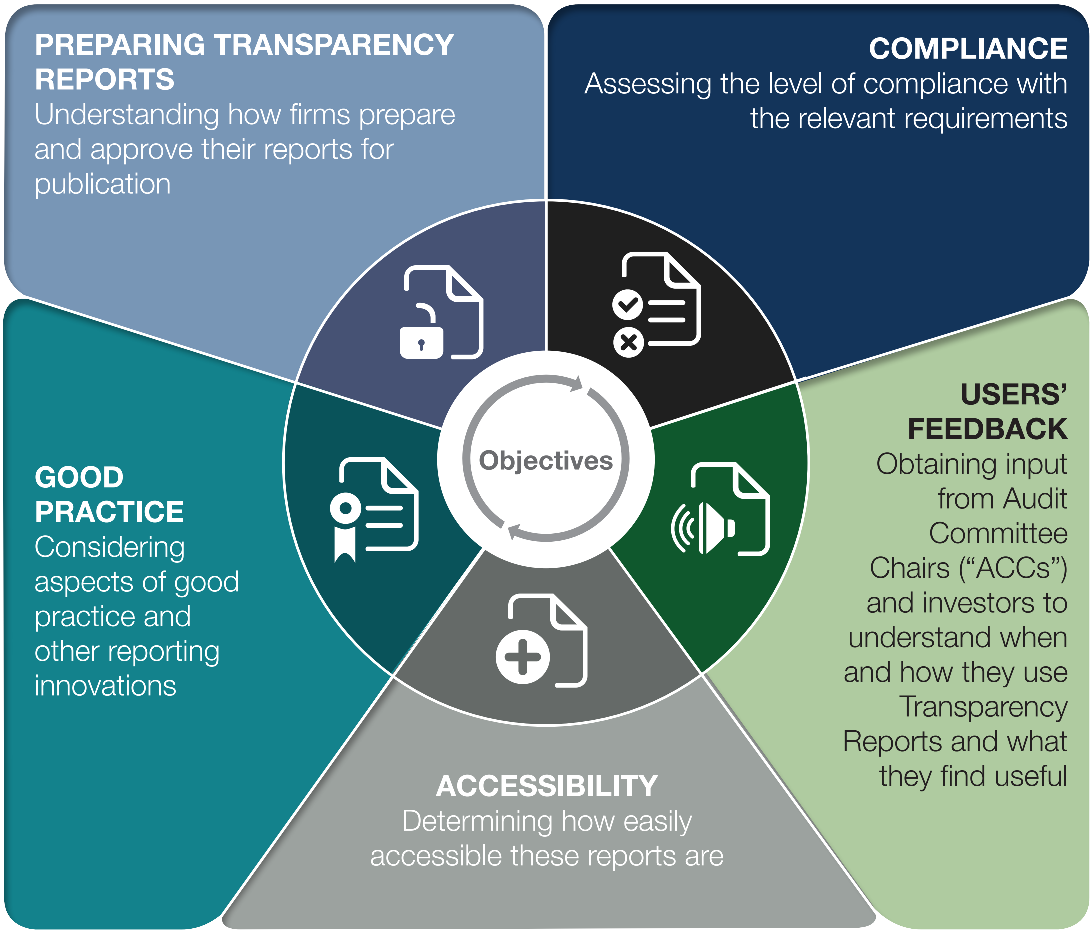
BACKGROUND TO THIS REPORT

Introduced in 2013, our thematic reviews supplement our annual programme of reviews of individual audit firms. The reviews are deliberately more focussed in scope, considering a selected area in greater depth than is generally possible in our review of audit engagements.

In this section, we describe the objective of this thematic review, explain who prepares Transparency Reports, and how we obtained evidence relevant to this review.

2.1. Objectives of this report

The objectives of this thematic review were to gain an understanding of the current state of Transparency Reporting in the UK, to share good practice and, where necessary, to highlight areas where firms need to make improvements. Relevant and comparable Transparency Reporting should help facilitate much greater engagement between auditors and users of financial information. This is crucial for auditors to build public trust and ultimately should help improve audit quality for the intended users. To gather evidence for this report we structured our review into the following areas:



2.2. Who prepares Transparency Reports and the relevant regulations

Each of the 33 firms that audit a PIE in the UK is required under EU regulations to prepare a Transparency Report. Of these, nine firms also apply the AFGC (three on a voluntary basis).

	Firms	
Firms within the expressed scope of the AFGC	6	BDO LLP ("BDO"), Deloitte LLP ("Deloitte"), Ernst & Young LLP ("EY"), Grant Thornton UK LLP ("Grant Thornton"), KPMG LLP ("KPMG") and PricewaterhouseCoopers LLP ("PwC")
Firms that voluntarily adopt the AFGC	3	Mazars LLP ("Mazars"), National Audit Office ("NAO")[1] and RSM UK Audit LLP ("RSM"),
Firms with one or more EU PIEs that only adopt the EU Regulation	24	Refer to Appendix B
Firms required to prepare Transparency Reports	**33**	

[1] The NAO is an independent Parlimentary body in the United Kingdom".

2.3. Scope and evidence base

The scope of this thematic review included 33 firms.

We gathered evidence for this thematic review from the following sources:

Reviewed the 2017 Transparency Reports of each firm. For the nine firms that adopt the AFGC, we also reviewed the 2018 reports to see how they had been updated (see section 3.5)

Sent questionnaires to the 15 firms with five PIEs or more

Met with the nine firms who apply the AFGC

Held a roundtable session with investors and met with a selection of ACCs

The information to be disclosed in Transparency Reports includes the following:

EU Regulation 537/2014[2]

- Article 13 requires auditors of EU PIEs to publish annual Transparency Reports
- These Transparency Reports are required to disclose information relating to the firm's legal structure, ownership, governance, and independence practices

Audit Firm Governance Code (2016)

- If a firm audits more than 20 entities listed on a regulated market, it is within the expressed scope of the FRC's AFGC 2016
- The AFGC requires firms to disclose additional information to the EU Regulation such as how the firms monitor their governance system, the appointment and focus areas of INEs, and a business risk assessment

Local Auditors (Transparency) Instrument 2015

- Audit firms undertaking major local audits of government and healthcare bodies must comply with the Local Auditors (Transparency) Instrument 2015
- This outlines the required content for Transparency Reports similar to those required by the EU Regulation 537/2014, with additional emphasis on disclosure of relevant training for local auditors

[2] The EU Regulation 537/2014 Article 13 apply to financial years commencing on or after 17 June 2016. These requirements supersede the FRC's Statutory Auditor's (Transparency) Instrument 2008 which apply only to financial years which commenced before 17 June 2016.

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THEMATIC REVIEW FINDINGS

The table below summarises our key findings, with references to the relevant sub-sections.

PREPARING TRANSPARENCY REPORTS (Sub-section 3.2)

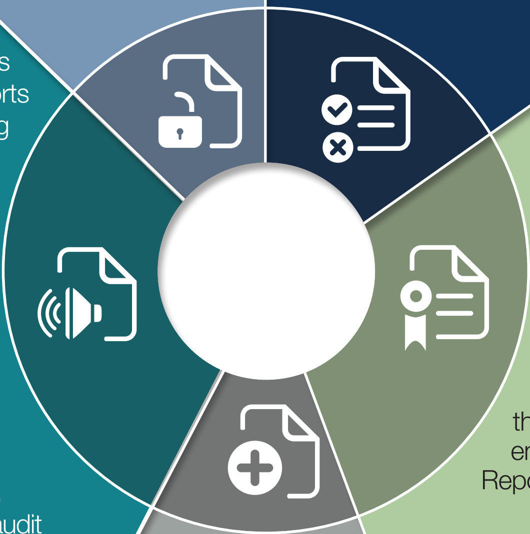
- Firms put considerable effort into preparing Transparency Reports.
- Many firms are using Transparency Reports as a marketing document - this often made the report considerably longer and less balanced for the reader.

COMPLIANCE (Sub-section 3.3)

- Non-compliance was identified primarily relating to some firms failing to disclose required information in line with the AFGC.
- Firms should do more to make their reports fair, balanced and understandable.
- Some audit firms had limited awareness of the local audit instrument.
- Five firms required to prepare and publish a Transparency Report under the EU Regulation (auditing one or more PIE but not adopting the Code) did not prepare a Transparency Report at all.

USER FEEDBACK (Sub-sections 3.1)

- Very limited awareness of Transparency Reports by key users, including ACCs and investors.
- Firms and users do not currently have timely dialogue and feedback relating to Transparency Reports.
- Investors want to understand systemic risks within the firm, and, where applicable, lessons learned from audit investigations.



GOOD PRACTICE (Included throughout report)

- There were good examples of firms using diagrams and infographics in their Transparency Reports to make information easy to read and understand.
- Some firms used a third party proof reader to ensure their Transparency Report could be understood by all users.
- Three firms voluntarily adopted the Code and three other firms (who are required to adopt the Code) adopted the revised Code early.
- A number of firms performed compliance testing of certain information in their Transparency Reports using separate teams within the firm.

ACCESSIBILITY (Sub-sections 3.4)

- We found that firms should ensure their Transparency Report is easy to find on their website and informs users why they should read it.

We encourage investors, ACCs, and other users of Transparency Reports to engage with audit firms to improve the content and accessibility of these reports.

3.1 User feedback – views from Audit Committee Chairs and Investors

The role of Audit Committees is fundamental to ensuring that investors and other stakeholders can have confidence in the quality and independence of the audit work being carried out. The Code specifically identifies investors and Audit Committees as intended users of Transparency Reports.

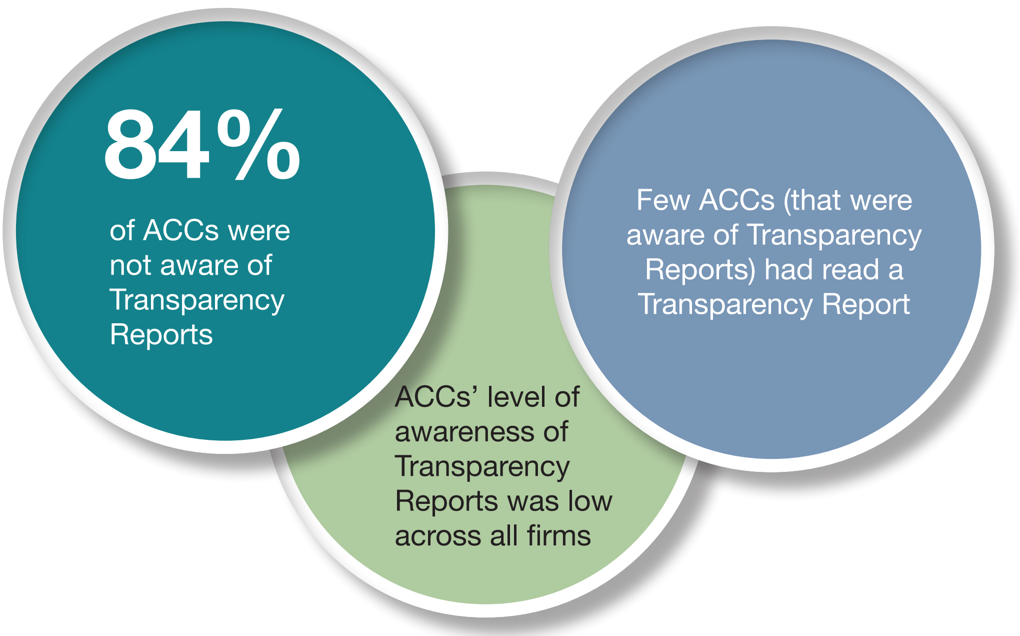
Audit Committees Guidance

The FRC Guidance on Audit Committees (April 2016)[3] on appointment and tendering states that the Audit Committee should annually assess, and report to the board on, the qualification, expertise and resources, and independence of the external auditors and the effectiveness of the audit process, with a recommendation on whether to propose to the shareholders that the external auditor be reappointed. The assessment should cover all aspects of the audit service provided by the audit firm and include obtaining a report on the audit firm's own internal quality control procedures and consideration of audit firms' annual Transparency Reports. The FRC's Practice Aid for Audit Committees issued in May 2015 noted that the Transparency Report may be a supplementary source of evidence for assessing the auditor's audit quality control over the audit.[4]

As part of our audit quality review inspections of individual audit engagements, we speak with ACCs prior to starting a review. During our 2018/19 review cycle, we incorporated specific questions to understand their awareness of Transparency Reports and to evaluate how useful the reports are in carrying out their duties as an ACC.

We spoke with over 50 ACCs as part of our audit quality reviews. 84% of ACCs were not aware of firms' Transparency Reports. Of the 16% of ACCs that were aware of Transparency Reports, few had actually read the report relevant to the audit firm that they engage with.

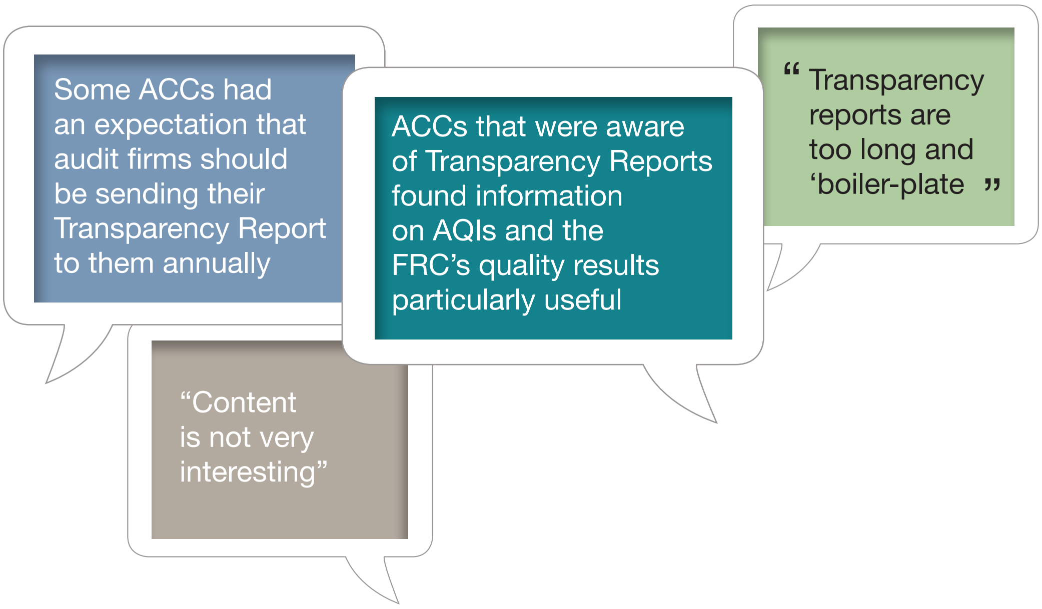
AC Chair survey



[3] https://www.frc.org.uk/getattachment/6b0ace1d-1d70-4678-9c41-0b44a62f0a0d/Guidance-on-Audit-Committees-April-2016.pdf

[4] https://www.frc.org.uk/getattachment/1738ea4e-167a-41e5-a701-f169e6b7e264/Audit-quality-practice-aid-for-audit-committees-May-2015.pdf

For the ACCs who were aware of Transparency Reports, feedback and views were fairly consistent and there was evidence that, despite some awareness, they still were not being read. We noted that, of the small number of ACCs who had read the Transparency Report, most did so specifically due to an audit tender process. In addition, feedback from those who were aware of Transparency Reports was that they were too long and overly positive to be useful.



Despite the lack of awareness and use of Transparency Reports, we were pleased to note that some of our discussions with ACCs prompted dialogue with auditors and ACCs requesting copies of the Transparency Reports. We are keen to see more ACCs actively engaging and challenging their auditors on audit quality based on the information produced in Transparency Reports on a regular basis, rather than in one-off instances during an audit tender.

Further, most of the firms we met with confirmed that they had limited, if any, engagement and dialogue with ACCs on their annual Transparency Reports. Some of the firms did not even cite ACCs as one of the users of the Transparency Report.

It was clear that firms we met with were not entirely sure what ACCs consider to be useful information in the Transparency Report and also whether Transparency Reports were useful for differentiating the firms from each other in order to assess and challenge audit quality. Some firms indicated that this could be part of the reason for ACCs having limited engagement with Transparency Reports.

Investors

We held an investor roundtable on Transparency Reports and AQIs. Our findings were similar to those relating to ACCs. In fact, for some investors, our roundtable was the first time that they had seen or heard of a Transparency Report.

Investors described Transparency Reports to us as:

"too long"

"difficult to navigate through"

"a marketing document"

One investor commented that they would only read a Transparency Report if they had a specific reason to and that "there would need to be a "blow-up" in the press".

Their view was that firms needed to focus on clear and concise messages in their Transparency Reports. Investors described a number of Transparency Reports as "far too lengthy" and did not know what information they were looking for and where to find it.

When asked what information they would find useful and want to see in Transparency Reports, investors agreed that risk, culture and the role and work of INEs were key. The updated Code specifically requires firms to report on these areas, suggesting the reason for a lack of use is not necessarily due to the Code itself. We have explored how effective the 2016 changes to the Code were in making Transparency Reports more relevant to investors in section 3.3 of this report.

It is evident from our discussions with the firms that there is an insufficient understanding of what information investors wish to see in the Transparency Reports.

Investor Dialogue

EY held an investor dialogue event focussed entirely on the 2017 Transparency Report, recognising that more engagement was needed between INEs and investors. EY received feedback from investors that they preferred and would find it more useful for the Transparency Report to be structured by topics and themes. EY reflected this in their 2018 Transparency Report.

GOOD PRACTICE

Some firms informed us that they had met with a group of investors where the Transparency Report had featured briefly on the agenda. Despite these meetings, it was clear that firms did not know what information outside of the AFGC investors find useful to be included in the Transparency Report. We encourage more focussed dialogue on this topic with investors going forward.

Audit Quality Indicators ("AQIs")

We note that the largest firms agreed a set of metrics to be reported in their Transparency Reports in the form of AQIs. This additional reporting increases transparency and comparability in audit quality amongst the firms. This is supported by some of the discussions we had with ACCs and investors who found particular value in AQIs and the FRC's AQR results.

We are conducting a thematic review on AQIs over 2019/20 and will report on their use in more detail in that report.

ACCs, investors and audit firms collectively need to establish effective and timely communication with each other on Transparency Reports and work together on challenging and improving audit quality.

3.2 Preparing Transparency Reports

Transparency Reports aim to provide just that, transparency – of the firm, of what they do and how they do it – in a balanced and informative manner. From our review of Transparency Reports and feedback from users, we note that reports would be more useful if they included a balanced view of challenges and risks facing the firm.

i) Purpose of Transparency Reporting

Firms should have a clear view of the purpose of the report they are preparing and ensure that this defines the style, content and time spent drafting the report.

From our reading of the Transparency Reports and subsequent meetings with the firms applying the AFGC, it was not always clear which stakeholders the reports were being written for and, therefore, the purpose of the report. One firm suggested that there is a general lack of understanding of the Transparency Report and its purpose.

A number of firms that adopt the Code view one of the purposes of the Transparency Report to be marketing in nature and a document primarily used and referred to in audit tenders.

Some of the firms adopting the Code explained the challenge they face in getting the right balance between a compliance and marketing document.

One of the firms auditing more than 20 listed entities explained that they did not make a huge investment in making the report "more exciting" with infographics, as they do not see this as a marketing document and any additional cost or level of effort would not add any further value to their compliance with the reporting requirements.

A key objective of Transparency Reporting is to provide information to stakeholders that informs their assessment of the appropriateness of the firm to perform audits and to assist them in holding the firm's leadership to account for key governance and performance matters.

Transparency Reports should not be written as a marketing document as marketing materials may have a bias towards highlighting the positive and ignoring the negative. This undermines the aim of publishing an open and transparent assessment of a firm's governance, values, independence and operational risk.

We found the firms that are required to adopt the Code produced, on average, much longer reports and spent significantly more hours preparing their Transparency Reports compared to the firms voluntarily adopting the Code with the same requirements.

We note that where reports were very long, it is likely that users would not spend the time needed to read the report in full or find the information that they wanted to read. Firms should carefully consider the length of their Transparency Reports and be much more focussed on ensuring the information that matters most to stakeholders is readily accessible and understandable.

We explore the principles of fair, balanced and understandable information and other aspects of compliance with the Code further in section 3.3.

Early preparation of Transparency Reports

All firms adopting the Code started the drafting process six to seven months in advance of the publication deadline and engaged with their senior leadership teams early for 'brainstorming' sessions prior to the drafting process. Many firms also included their INEs at this early stage so that they could provide their perspective on what information would be most useful to stakeholders.

GOOD PRACTICE

Time spent drafting Transparency Reports

	Number of firms	Length of reports	Average length	Range of hours spent preparing	Average hours spent preparing
Firms within the expressed scope of the AFGC	6	52-164 pages	95 pages	235-1,340 hours	794 hours
Firms that voluntarily adopt the AFGC	3	19-50 pages	34 pages	33-194 hours	125 hours
Other firms with one or more EU PIEs that only adopt the EU Regulation	24	4-23 pages	11 pages	2-102 hours	38 hours
All firms preparing Transparency Reports	**33**		**41 pages**		**315 hours**

Readability of reporting

The NAO took 55 hours to produce and draft its Transparency Report which was done concurrently with its annual report. The NAO does not view the purpose of the report to be a marketing document. We found information contained in the NAO's Transparency Report to be easy to read and process, with good use of meaningful infographics. This was a good example that demonstrates the balance of effort and investment put into the preparation of a Transparency Report.

GOOD PRACTICE

The Transparency Reports of firms auditing one or more EU PIE (who do not adopt the Code) were often shorter and more aligned to the necessary information required by the EU directive and seemed to us to be less of a marketing document than those of the firms adopting the Code.

ii) Readability

We found good examples of innovative reporting both in physical form and online, including the use of meaningful infographics to aid the reader's understanding.

Innovative reporting

- Mazars and the NAO made good use of diagrams and infographics in their reports, especially for information that was not always easy to digest or understand.
- EY included a number of short "sound-bite" interviews from the leadership team on its website for its Transparency Report. This provided a summary of the key messages included in the Transparency Report.

GOOD PRACTICE

Use of plain English

- All firms use separate internal teams to proof read versions of the Transparency Report before it is published.
- EY and Grant Thornton engage with an external editor to proof read their final report with the aim of limiting the use of technical jargon that may not be easily understood by all stakeholders.

GOOD PRACTICE

To ensure Transparency Reports are readable and easy to understand, we recommend that firms:

- Make use of infographics to deliver succinct messages that are easy to understand
- Shorten narratives so that they are concise
- Put standing data in appendices to the report
- Limit the use of technical jargon

iii) Reliability

A number of firms adopting the Code perform compliance testing of certain statements and information included in their reports using separate teams within the firm, such as internal audit and forensics. Given the number of individuals and teams involved in drafting the report, along with the volume of information, the firms informed us that they found the verification process to be an important part of preparing their reports.

3.3 Compliance

i) Scope of our compliance review

As part of our review of audit firms' compliance with the relevant laws and regulations, we focussed on the nine audit firms that applied the AFGC in 2018, which was the first year that all firms in scope were required to report against the new AFGC 2016.

- Six audit firms (BDO, Deloitte, EY, Grant Thornton, KPMG and PwC) are required to adopt the AFGC.
- Three audit firms (Mazars, the NAO and RSM) choose to voluntarily adopt the AFGC.

Voluntary adoption of the AFGC

We consider Mazars and RSM's willingness to adopt the Code voluntarily as an example of good practice and indicative of the firms having a desire to meet good standards of governance and reporting. They also explained that adopting the Code allowed them to really challenge their governance and processes as a firm.

GOOD PRACTICE

We have set out our findings and examples of good practice in the section below.

ii) Audit Firm Governance Code 2016

Compliance with the AFGC is intended to enhance trust and confidence in the value of audit amongst the public and particularly investors.

During 2014/15 the FRC reviewed the 2010 AFGC's implementation and raised a number of findings, including:

- The AFGC (2010) had insufficient visibility and Transparency Reports were not widely read;
- Investors were not clear about the role which INEs played; and
- Dialogue with investors had not worked as well as had been hoped.

The 2016 revisions to the AFGC introduced new required content of greater relevance to investors, regulators and other stakeholders as part of firms' Transparency Reporting. This included, amongst other revisions, a greater focus and reporting of: the KPIs used to monitor the performance of the governing bodies; the INEs' role within the firm; and the audit firm's risk assessment of events or matters that could threaten the performance or viability of the firm.

Early adoption of the 2016 AFGC

We were pleased to note that three firms (Deloitte, EY and Grant Thornton) adopted the 2016 AFGC early. Firms explained that early adoption was aligned to their commitment to adopt best practice and to support the principle of increased transparency. It also allowed a dry run prior to required adoption so that difficulties and issues could be ironed out, making the 2018 reporting process easier.

GOOD PRACTICE

2018 was the first year that firms were required to comply with the updated AFGC (2016). We have therefore focussed our compliance review on the 2018 Transparency Reports for each of the nine audit firms in scope. Our summarised findings are noted below:

✓ Compliant — Partial compliance ✗ Non-compliant

AFGC title	Summary findings	Firm							
		A	B	C	D	E	F	G	H
Impact of INEs – independence of firm and INEs [C.2.1]	Seven firms did not state the firm's criteria for assessing the impact of INEs on firm's independence as auditors and three firms also did not disclose their criteria for assessment of the INE's independence.	—	—	—	✓	—	✗	✗	✗
Governance – KPIs and monitoring [B.1.2]	One firm did not disclose KPIs and report on performance against them. One firm had not introduced KPIs.	✓	—	✓	✓	✓	✓	✓	✗
Involvement of INEs [C.1.3]	Three firms did not disclose how INEs assess the firm's reputation and risk of firm failure.	✓	—	—	✓	✓	✓	✓	—
Conflicts of interest [D.1.3]	Compliant.	✓	✓	✓	✓	✓	✓	✓	✓
Effectiveness of internal control and process to confirm actions taken to remedy findings [D.2.2]	Mostly compliant.	✓	✓	✓	✓	—	✓	✓	✓
Audit firm risk assessment [E.3.1]	Mostly compliant; however, investors feedback noted they wanted enhanced disclosure of systemic challenges to delivering consistently high quality audits and firm's responses.	✓	✓	✓	✓	✓	✓	✓	✗

*We have not included NAO in this table as they have voluntarily prepared their Transparency Report 2017- 2018 on the AFGC 2010 and it is therefore not comparable to the other firms and the updated provisions.

Explanation of the AFGC (2016) provisions relating to Transparency Reporting

AFGC Title	Rule / Provision
Impact of INEs – independence of firm and INEs	C.2.1 The firm should state in its Transparency Report its criteria for assessing the impact of INEs on the firm's independence as auditors and their independence from the firm and its owners.
Governance – KPIs and monitoring	B.1.2 Firms should introduce KPIs on the performance of their governance system, and report on performance against these.
Involvement of INEs	C.1.3 The INEs should report on how they have worked to (a) Promote audit quality (b) Help the firm secure its reputation more broadly, including in its non-audit businesses (c) reduce the risk of firm failure.
Conflicts of interest	D.1.3 The firm should state in its Transparency Report how it applies policies and procedures for managing potential and actual conflicts of interest.
Effectiveness of internal control and process to confirm actions taken to remedy findings	D.2.2 The firm should state in its Transparency Report that it has performed a review of the effectiveness of the system of internal control and confirm that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review.
Audit firm risk assessment	E.3.1 The firm should disclose its assessment of the principal risks facing the audit firm, including those that would threaten its business model, future performance, solvency or liquidity.

In addition to the provisions in the table above, the revisions to the AFGC in 2016 required firms to produce Transparency Reports that are fair, balanced and understandable. At present firms include a variety of useful information, including the audit quality results from internal and external inspections. Often this shows that audit quality is below expectations and firms report on this in an open and transparent way. However, to fully meet the principle of being fair and balanced, and to improve trust in audit, we believe firms need to enhance their reporting on the underlying challenges they face to delivering consistently high quality audits and how successful they are being at mitigating those challenges.

One example of this relates to resource levels within audit firms. The firms often report in their Transparency Reports whether their engagement teams felt they had sufficient resources to enable them to deliver high quality audits. Often the results show that there is resource pressure within the firms and in some instances this pressure has increased. This in itself is useful and transparent reporting. However, there is little commentary on why this continues to be a challenge or what firms are doing differently to mitigiate the challenge compared to previous years.

Governance KPIs

ACCs and investors were interested in understanding the overall governance structure and processes and how this was monitored by the board.

KPMG and EY set out their KPIs related to governance monitoring and assessment clearly in their Transparency Report. This included KPIs related to: gender diversity of the board; range of skills on the board; brand; culture; and INEs.

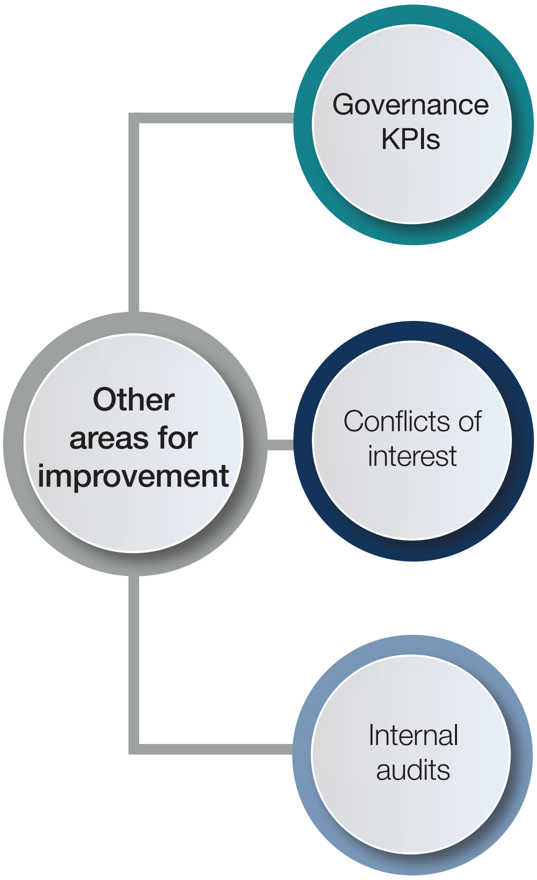
GOOD PRACTICE

INE Reports

Investors at our round table discussion wanted more information about INEs and what their focus areas and impact on the audit firm was during the year.

PwC's INE Report had a good overview of their Public Interest Body's ("PIB") activities in the year and its focus on reputation and culture of the firm. The disclosure relating to how INEs are involved in the firm's processes and the externally facilitated effectiveness review of the PIB and improvements to be implemented by the end of 2018 were particularly insightful.

GOOD PRACTICE



Firms should clearly state the KPIs used to monitor the performance of their governance system in their Transparency Report. We would expect that there would be more than one KPI used for monitoring governance.

Most firms made “boiler plate” disclosure of their independence issues but did not disclose any recent or publicised independence conflicts and how these were dealt with by the firm.

Although most firms met the provisions of the AFGC, it was not clear what the results of internal audits performed during the year were and no examples were given to provide practical and informative details to users of the report about the firm’s robust processes and improvement areas.

Overall, there was mixed compliance in terms of implementation of the AFGC 2016 Transparency Reporting disclosures. We note that across the Transparency Reports reviewed, firm’s could improve the content of Transparency Reports by including a more fair and balanced disclosures relating to the current audit environment, closed investigations, and systemic risks applicable to the firm.

iii) EU Regulation 537/2014

The EU Regulation requires all firms auditing one or more EU PIE to publish an annual Transparency Report. We identified five firms in our review that did not publish a Transparency Report and therefore did not comply with the requirements. We have written to these firms to notify them of their non-compliance and requested that they remediate this within a specified time period. We will monitor their compliance and take further action, such as through audit enforcement procedures, as necessary.

The requirements of the EU Regulation are prescriptive and compliance focussed. Overall, audit firms that produced Transparency Reports complied with most of the requirements of the EU Regulation.

However, firms are required to publish their Transparency Reports within four months of their year-end. In approximately half of cases, the date of approval / publication was not disclosed so it was not possible to confirm whether the requirement had been met.

Firms should clearly state the date that their Transparency Report was published and notify the FRC of where it can be found.

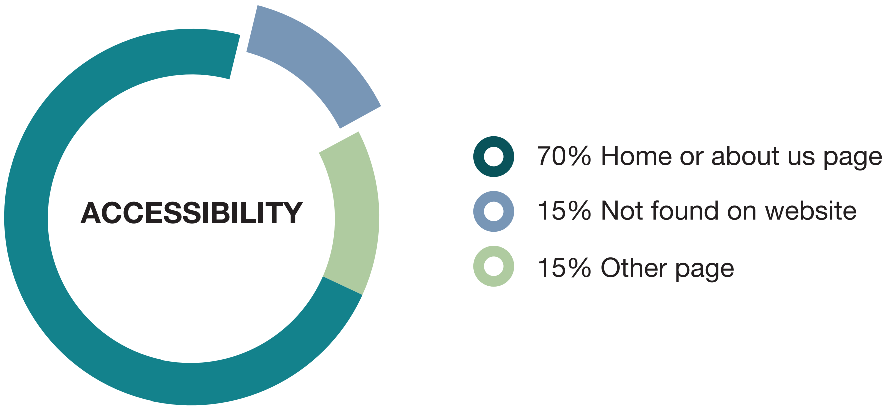
iv) The Local Auditors (Transparency) Instrument 2015

Firms conducting major local audits are required to comply with the Local Auditors Transparency Instrument 2015 (the "Instrument"), which includes disclosing all major local audits undertaken by the firm. Seven firms (BDO, Deloitte, EY, Grant Thornton, KPMG, Mazars and PwC) currently fall into the scope of these requirements. We found that the awareness of and compliance with these requirements was mixed amongst the firms. Some of the firms were simply not aware of the specific requirements and did not comply with the Instrument in the 2017 Transparency Reports reviewed.

We note that firms subsequently rectified this for the most part in their 2018 Transparency Reports; however, we have written to individual firms separately to notify them of any non-compliance with the Instrument and will take further action, such as through audit enforcement procedures, as necessary.

3.4. Accessibility

We assessed how easy it was to find each firm's Transparency Report on its website. Transparency Reports were most commonly located in the 'about us' section of a firm's website. Transparency Reports that were located elsewhere on a firm's website were harder to find and achieved less visibility.



Greater consistency and sign-posting of where a user can find a firm's Transparency Report would help them to access it more easily. This is particularly helpful if users are simply trying to find out about the firm but may not be aware that a Transparency Report exists or what its purpose is. Many firms commented to us that users may not understand what a Transparency Report is and therefore may not even open it to see what it contains. This point was also raised by investors who wanted to know why it was important for them to read a Transparency Report. In this regard, it would be helpful if websites included a short explanation of what a Transparency Report is and why a user should read it.

We recommend that firms include their Transparency Report within the 'About us' pages with a short explanation of why a user should read it.

3.5. Further updates to 2018 Transparency Reports

We initially gathered evidence for this thematic review from the Transparency Reports published in 2017 and recognise that a number of firms covered by our review had since published their 2018 Transparency Reports. We reviewed these reports and were pleased to see that all firms we met with had made positive strides in further improving the quality of their Transparency Reporting. Examples of improvements included:

- KPMG decided to separate their Transparency Report from their annual report in 2018 so that they could focus on key messages regarding audit quality.
- EY produced their Transparency Report in one document in 2018, rather than volumes, and structured it by themes and topics after receiving feedback from investor groups. EY also included 'case studies' throughout the Transparency Report that demonstrate good practices within the firm. This allows users to gain insight into 'real-life' examples of how issues discussed in the Transparency Report are dealt with in practice within the firm.

Culture assessment and monitoring

In the 2016 update to the Code, the FRC recommended that firms' Transparency Reports should set out what the Board and the INEs have done to satisfy themselves that an appropriate culture exists throughout the organisation. Further, our audit culture thematic review that was published in May 2018 identified that firms needed to improve significantly the public reporting (in Transparency Reports) of their processes to assess how their culture supports the delivery of high quality audits.

All firms adopting the Code acknowledged the key findings from the audit culture thematic review in their 2018 Transparency Reports and the importance and focus on culture within the firm. However, there were few examples of how firms actually assess and monitor their culture and therefore what they have done to address the findings of the FRC's culture thematic as a result. Deloitte, EY and KPMG explained the basis used to assess and subsequently monitor their culture. The remaining firms adopting the Code did not report on how they were approaching this.

It is clear that further improvement still needs to be made by firms in their reporting on culture, in particular acknowledging what they have identified as their key challenges to audit culture and what has been done to address these challenges going forward.

A

QUESTIONS TO ASSIST AUDIT COMMITTEE CHAIRS AND INVESTORS

1. How do firms monitor culture and what KPIs are used in the governance process relating to culture?

2. Can you provide some examples of conflicts of interest that have been identified by the firm and how these were escalated and resolved?

3. Can you provide additional information about the independence checking process and how the firm deals with identified conflicts?

4. How many clients has the audit firm won / lost in the year? How has this impacted the viability of the firm and its ability to operate?

5. What is the percentage of staff turnover in the year compared to the prior two years? What is the firm's view of the relationship between culture and attrition rates and how would it address a rising rate of attrition?

B

LIST OF FIRMS THAT AUDIT ONE OR MORE EU PIE THAT ONLY ADOPT THE EU REGULATION

1+

- Crowe UK LLP
- Beever & Struthers
- Haysmacintyre
- Jeffreys Henry
- PKF Littlejohn
- UHY Hacker Young
- Alder Shine LLP
- Barber, Harrison, & Platt
- Begbies
- BSG Valentine
- Carter, Becker, Winter
- Edwards Accountants
- FW Smith & Riches
- French Duncan
- Gerald Eldman
- Greenwich & Co.
- Haines Watts Birmingham
- Hazlewoods
- Hope Jones
- HW Fisher & Co.
- Johnstone Carmichael
- SBM Associates Limited
- Scott Moncrieff
- Watson Buckle

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