

March 2015

Transparency Reporting by Auditors of Public Interest Entities

Review of Mandatory Reports

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One - Introduction and background

Introduction

1. This is the third review by the Financial Reporting Council of the contents of transparency reports produced by auditors of public interest entities. Publication of these reports has been mandatory since 2010.
2. In our previous reviews in 2009 and 2010 the FRC identified a number of issues which we recommended that firms should consider when drafting future reports. We followed up the extent to which our recommendations had been implemented in 2010 and have repeated this exercise again in 2014.

Background

3. The Statutory Audit Directive, which came into force in 2006, introduced a mandatory requirement for annual transparency reporting by auditors of UK companies with securities admitted to trading on a UK regulated market. In the UK, effect was given to this through the Statutory Auditors (Transparency) Instrument 2008, published by the Professional Oversight Board in April 2008 (formerly an operating board of the FRC) following consultation. It applies in respect of any financial year of a relevant audit firm starting on or after 6 April 2008.
4. In its first year when the requirement to report was optional, seven of the ten largest firms chose to publish a voluntary transparency report. Since then the number of firms required to produce Transparency reports has fluctuated year on year. In the first year of mandatory compliance, 40 firms were required to produce such reports and in the year to 31 August 2014 32 firms were required to produce them. Of these, 30 had been produced. This included all of the nine largest firms.
5. Those firms which were in default were requested in writing to produce a transparency report within 30 days. Firms that failed to comply were referred to their Recognised Supervisory Body.
6. As in previous years, it should be noted that this review does not include an assessment of whether the statements made in transparency reports are factually accurate, as this could only be achieved through a thorough inspection of each firm. For those firms subject to full scope inspections by the Audit Quality Review team (AQR), transparency reports are reviewed for consistency with AQR's knowledge of the firms from monitoring work. We understand the monitoring units of both the ICAEW and ICAS do likewise.

Two - Executive Summary

7. Overall, we believe that the quality of reports in 2013/14 is significantly higher than that of the reports we reviewed in 2010. There remain a few areas which require improvement to meet the minimum requirements of the Statutory Audit (Transparency) Instrument 2008 but generally we are pleased with the level of content of these reports and pleased to see that firms are taking the time to consider how to make them more relevant for their readers by considering current issues in the market place. These include developments taking place at national and European levels which could impact on their future conduct. We are also pleased to see helpful and informative reports continuing to be produced by some of the smaller firms.
8. The reports necessarily contain data that may be regarded as marketing. The general tenor of the reports, however, indicates that firms have resisted the temptation to turn the transparency reports into marketing documents; preferring to stick to descriptions of the firm and its policies and procedures. The use of boilerplate statements appears to have been largely avoided by all firms.
9. A small number of firms continue to include some information that properly belongs in the transparency report in other publications. In our view the reports that include all relevant information in one document are the most helpful and effective. However, we do not wish to discourage firms from continuing to develop innovative formats for their transparency reports. As long as the reports capture all relevant requirements, firms should not feel obliged to follow a set template.
10. In the past, we have noted that although many reports include a high quality narrative describing internal quality control and other systems, none provided any objective measures for assessing the effectiveness of those systems. A significant number of firms now provide details of the key performance indicators which they track internally but are stopping short of providing details of actual performance against those indicators.
11. We have previously commented that we believed firms were failing to differentiate themselves from their competitors by placing insufficient focus on audit quality, despite stating that audit quality was important to them. We are encouraged to see that firms are now describing in greater detail the processes they have in place to achieve a high standard of audit quality.
12. It is encouraging to see that the Professional Reputation Group¹ (PRG) has gone even further than the Statutory Audit (Transparency) Instrument 2008 and specified further factors it would like to see reported by the six largest firms; external investigations, audit quality reviews, investments in audit staff, investor liaison and staff surveys, which in many cases are being included in the 2014 reports for the first time. Where these transparency reports have been published after the period covered by this review we have included comments on our findings on these additional factors within this report.
13. Another initiative of the PRG was for its member firms to provide greater detail within their transparency reports of any disciplinary cases against them. However, not all of

¹ a forum for the six largest firms (BDO, Deloitte, EY, Grant Thornton, KPMG and PwC) to debate topical public interest issues that impact on the reputation of the firms collectively and on the profession

these firms have provided details in their most recent reports and have also not confirmed that there are no current investigations. We would encourage all firms to consider including both actual performance figures in future reports and details of disciplinary action to which they are subject.

14. The main issue which should be addressed by all firms as a matter of priority is the publication of target KPIs and the outcomes against those targets.
15. A number of other common themes have emerged that we believe should also be addressed. In particular, we would recommend that firms improve the quality of their disclosures in the following areas:
 - International networks;
 - Financial information;
 - Independence procedures and confirmation that a review has been conducted
 - List of Public Interest Entities.
16. Any comments on the information within this report, and on transparency reporting in general, should be sent to s.ahmad@frc.org.uk .

Three – Detailed commentary

Our specific comments, set out under each of the requirements in the Statutory Instrument, are set out below. Points which we expect firms to action are in bold.

(a) A description of the legal structure and ownership of the transparency reporting auditor

17. All firms provided a description of their legal structure and the vast majority provided further information including the number of partners/members, the number and location of offices, the number of related UK firms or overseas branches and principal lines of business, etc.

18. We have no further recommendations at this time.

(b) Where the transparency reporting auditor belongs to a network, a description of the network and the legal and structural arrangements of the network

19. 22 of the firms whose reports we reviewed reported that they belonged to an international network. Those that did not belong to a network stated this explicitly, or explained that although they were not part of a network, they did have arrangements with overseas firms to facilitate cross-border client work. All firms were open about the name and legal form of their network and included one or more indicators of their size.

20. All networked firms reported information on their governing bodies, including names of key partners, functions of committees and procedures for appointments to the governing body and committees. We are pleased to see this continuing improvement in the information provided.

21. In contrast to our previous review, all firms commented on the extent to which they were linked to their international networks. However, as noted in our previous review, many of the reports reviewed lacked a clear and detailed explanation of the rights and responsibilities conferred on member firms by the network agreement. Where agreements are mentioned, the emphasis continues to remain on stressing that each firm is a separate legal entity, revenues/ profits are not shared and that the central organisation does not provide services directly. Notwithstanding risk management considerations around contagion and the need for firms to protect themselves from cross-border litigation, our view remains that the descriptions of networks and network agreements in the transparency reports do not in most cases accord with the way in which those networks appear to operate in practice and, in particular, how they are presented to clients.

22. We would recommend that firms provide greater clarity in this area in future reports.

23. It is encouraging to find firms are considering the relevance of post-year end information to their transparency reports. During the period under review for this report, two firms (Baker Tilly and RSM Tenon) merged to form a new enlarged firm. Shortly after its year end, the new firm transferred from one international network to another. The Transparency Report focuses primarily upon the network into which the new firm transferred shortly after the year end with only a short section on the network from which

it withdrew. We feel this is helpful for readers of the report to understand the network within which the firm is now operating rather than the one which it has already left.

(c) A description of the governance structure of the transparency reporting auditor

24. As in previous years, we feel that the clarity and level of disclosure provided by the firms have been appropriate and adequate for their size and structure.

25. We have no further recommendations for firms at this time.

(d) A description of the internal quality control system of the transparency reporting auditor and a statement by the administrative or management body on the effectiveness of its functioning

26. As noted in our earlier review, this section continues to be the most informative in the transparency reports of most firms. Highly detailed disclosures are provided by most firms under each of the component parts of their quality control systems that follow the International Standard for Quality Control (ISQC1).

27. In addition to the elements of ISQC1, the more informative reports also include detailed considerations of factors outside the control of the auditors that could impact upon how they operate; such as the review of the audit market by the Competition and Markets Authority (CMA), formerly the Competition Commission, and the new requirement for companies to re-tender audits at least every ten years.

28. The level of detail provided under each heading is comprehensive; particularly in relation to engagement performance and internal monitoring, with most firms describing their audit methodology in detail.

29. It is encouraging to see that, following our previous comments on the lack of information on Human Resources, this section has been enhanced by most firms and now typically includes information on recruitment, training, promotion criteria and ongoing support for staff development.

30. Although only five firms made specific reference to the FRC's Audit Quality Framework (AQF) or its drivers, it is evident from the reports that these are being addressed. Reference to the AQF is helpful in some reports, especially where this introduces a discussion on aspects of audit quality not otherwise covered by ISQC1. A number of reports include, for example, a section on factors outside the firm's control that may affect audit quality. One report (PwC) includes an example of its vision of audit in the future and how confidence in audit may be restored. We believe that disclosures such as these are informative for readers and may serve to increase confidence in audit firms.

31. The six largest audit firms have worked together through the PRG, to identify new factors which contribute towards audit quality and have come up with five new metrics which they have all agreed to disclose in their transparency reports; external investigations, audit quality reviews, investments in audit staff, investor liaison and staff surveys. These new metrics are being included in the 2014 reports for the first time in many cases. All six members of the PRG have provided varying levels of detail on each of the five metrics identified in their 2014 reports. Only two firms included details of disciplinary cases in their 2013 report.

32. The Big Four firms have all provided details of FRC disciplinary proceedings against them which have either commenced, are ongoing or have been closed in the year. Two firms (KPMG and Deloitte) separated out those investigations which relate to ethical breaches. Two firms (Deloitte and EY) have provided details of fines they have paid in the year. Two firms (BDO and Grant Thornton) reported only that they had no findings against them in the last 12 months.
 33. Two firms (EY and Deloitte) provided details of ongoing disciplinary cases being conducted against them by other external regulatory bodies. One firm (Grant Thornton) stated that two investigations had found against the firm in the last 12 months but no details were provided of penalties imposed by the regulatory body.
 34. In addressing issues faced by auditors in 2013, only one firm (EY) included a section on interactions with stakeholders but all six firms have addressed this issue in 2014.
 35. A number of reports have attempted to address concerns raised previously by providing greater detail of their key performance indicators. Only two firms, however, (PwC and KPMG) have provided details of actual performance against these indicators in the year under review. The more recent reports of a further three PRG members, now include details of AQR gradings. One firm (Grant Thornton) has referred readers to the FRC website for a copy of its AQR report.
 36. **All firms should consider providing detail on their key performance indicators (KPIs), and their internal assessments of performance against these KPIs in future reports. These details should be provided in the body of the report for ease of reference.**
 37. In the first year of our review, a number of reports included unequivocal confirmation that the firm's management was satisfied with the operation of their internal quality control system. We recommended in our follow up review that more firms should include such a statement in future reports and we now note that only 5 firms have failed to do this.
 38. **Those firms which did not include such a statement should do so in future reports.**
- (e) A statement of when the last monitoring of the performance by the transparency reporting auditor of statutory audit functions... took place*
39. As in the past, all reports referred to monitoring by both the Audit Quality Review (AQR) Team (formerly the Audit Inspection Unit) and their Recognised Supervisory Bodies. Some of the larger firms also included information on reviews by overseas regulators. Some reports did not specify the date(s) of the last inspection(s) even though this is a specific requirement.
 40. We have commented in prior reviews that reports have failed to enable a reader to distinguish between firms. It was not evident to us that firms were attempting to distinguish themselves from their competitors on the grounds of quality. Whilst a number of the 2013/14 reports have attempted to address this concern by including the outcomes of AQR reviews, only two firms (PwC, KPMG) have gone so far as to include the AQR's assessment of audit quality together with its key messages to the firm. A few other firms have included the AQR's key messages to the firm in their reports. Many firms summarised the results of external monitoring and/or included links to AQR reports and a few included an explanation of actions taken to address matters raised by external bodies.

41. We would encourage all firms to provide as full a picture as possible of the results of external monitoring. We would, however, discourage firms from quoting only positive parts of external monitoring reports, especially since selective quotes may be taken out of context and/or misrepresent the intended message. This may assist with marketing, but it is in our view inappropriate in a transparency report.

42. **Those firms that did not include the date(s) of their last inspection(s) should do so in future reports. All firms should consider providing more detailed information on the results of external monitoring.**

(f) A list of public interest entities in respect of which an audit report has been made by the transparency reporting auditor in the financial year of the auditor

43. Only one firm (PKF Littlejohn LLP) failed to provide this information, either through a list of audited entities in the report or via a link to the firm's own website. Larger firms generally published a list of audited entities as at a certain date, rather than a complete history of all public interest entities audited during the year.

44. A few firms have included other major audited entities on their list and whilst we have no objection to this, we would suggest that the report indicates which of these audits are in relation to "public interest entities" under the Statutory Instrument.

45. **Provision of this information is a specific requirement and therefore should either be included in the transparency report or clearly linked to the site where it may be found.**

(g) A description of the transparency reporting auditor's independence procedures and practices including a confirmation that an internal review of independence practices has been conducted

46. Whilst all firms have provided information on their independence procedures and practices the quality of the information provided is variable. Many firms provide separate sections setting out their independence policies and practices in detail. Perhaps unsurprisingly, this is true of the reports of larger firms who have more complex procedures. Amongst the smaller firms, however, even the details of the actual policies in this area are often vague.

47. Despite systems often being described in considerable detail, most firms failed to address how any issues identified through this process are followed up.

48. Only five firms failed to confirm that an internal review of independence practices had been conducted; making only vague references to practices being under constant or regular review.

49. **We do not consider that firms have met the requirement in this area and we request that firms correct this in future reports.**

(h) A statement on the policies and practices of the transparency reporting auditor designed to ensure that persons eligible for appointment as a statutory auditor continue to

maintain their theoretical knowledge, professional skills and values at a sufficiently high level

50. All reports address human resource issues but the quality of the information provided is variable.
 51. In line with the agreement reached by the PRG, the five largest audit firms which have produced their 2014 reports have included a considerable amount of detail on the specific training requirements of their audit staff. Each of these firms has also provided details of surveys run to gather the views of their staff. The level of detail on these surveys varies considerably. Three firms have provided details of the questions they intend to seek feedback on and have undertaken to report back on these in 2015. Two firms (Grant Thornton and PwC) have provided only anecdotal evidence of staff feedback.
 52. The larger firms tend to provide greater detail in this area with some describing specific training requirements that all senior audit staff, not just RIs or partners, are required to attend. A few of the smaller firms (BSG, Chiene & Tait, UHY Hacker Young, Shipleys LLP) do little more than state that they have procedures for recruitment, appraisals, remuneration and professional development without providing any details.
 53. Most firms have mentioned the need for staff to maintain their CPD and provided some information on the firm's policies and procedures for ensuring that audit partners and staff maintain their skills and technical knowledge.
 54. **All firms should consider disclosing mandatory courses for their audit partners and/or staff and any other distinguishing features about their training and monitoring of CPD.**
 55. Each of the PRG member firms which have already reported in 2014 have mentioned internal surveys run by the firms to gather the views of their staff. However, the level of detail provided in the transparency report on the outcome of these surveys is limited. Three firms have provided details of the questions on which they intend to seek feedback and have undertaken to report back on these in 2015. Two firms (Grant Thornton and PwC) have provided very limited data on the outcome of specific audit related questions asked as part of past staff surveys.
 56. **We would encourage all the larger firms to consider publishing the questions on which they will be seeking staff feedback and report their findings in future transparency reports together with steps taken to address the issues highlighted. Smaller firms should also consider whether this may help them raise audit quality.**
- (i) *Financial information for the financial year of the transparency reporting auditor to which the report relates, including the showing of the importance of the transparency reporting auditor's statutory audit work*
57. Only one firm failed to provide any financial information, whilst a further seven provided only total revenue and revenue from statutory audit work.
 58. Amongst those firms that provided financial information in greater detail, the level of analysis of fees varied considerably. Whilst their reports contained details of the quantum of revenue from the provision of statutory audit services, only half disclosed the

level of fees arising from the provision of non-audit services to non-audit clients. Further, only three firms provided any analysis of this non-audit work.

59. Four firms failed to provide comparatives for previous years.
60. All firms (except two) falling within the scope of the Voluntary Code of Practice on Disclosure of Audit Profitability provided details of audit profitability within the transparency report. Of the two which did not provide this information one (Baker Tilly) included a statement indicating where this information may be found whilst the other firm (EY) remained completely silent.
61. Overall, we were disappointed with the quality of disclosures in this area. Although some firms provided clear financial information under all the suggested headings, along with an explanatory narrative, these were in a minority.
62. There were examples of firms disclosing revenues from “assurance” rather than statutory audit work specifically, making comparisons between them and other firms difficult. We have no wish to burden firms by forcing them to change their internal accounting systems purely for the transparency report, but we would recommend that, where the current disclosures cover a wider category of work than statutory audit, a more granular level of detail is provided.
63. Although we realise that firms structured as LLPs or limited companies are already required to disclose some of this information in their annual accounts, the transparency report is intended to be a standalone document and as such we believe that such information should also be included in this publication.
64. **We recommend that firms improve the level of information disclosed in this area.**

(j) Information about the basis for the remuneration of partners

65. All firms provided some information about the basis for the remuneration of partners and the vast majority described the various elements of partner remuneration. This may include a semi-fixed “salary” element, a profit-share, a performance-related component and/or a payment based on length of service or seniority. Some firms stated specifically that the performance-rated component was linked to quality of work and/or compliance with ethical and independence requirements.
66. Despite the recommendation in our previous report, none of the reports we looked at set out clearly the relative importance attached to each component of partner remuneration. We consider that the information disclosed would be more meaningful if firms were to give some indication of the weight given to each element.
67. Five of the reports failed to confirm that audit partners were not remunerated on the basis of selling non-audit services to audit clients.
68. **We would remind those firms which did not include such a confirmation that they should do so in their next transparency report.**

Appendix 1 - Issues arising from the 2008 and 2009 reports

Requirement	2009 findings	2014 comments
<p>Where the UK audit firm belongs to a network, a description of the network and the legal and structural arrangements of the network.</p>	<p>Although this year's reports saw an increase in detail on the structure and governance of international networks, there remained a lack of information on the obligations and undertakings included within network agreements. Additionally, the language used in the description of the network was often legalistic and defensive in tone.</p>	<p>The reports provide a considerable amount of detail on the structure and governance of the international networks. Many provide details of the key partners, how these positions are filled and the details of the sub committees</p>
<p>A description of the governance structure of the UK audit firm.</p>	<p>The description of the UK governance structure in most reports was in our view adequate. Larger firms tended to provide information on important sub-committees and names of key partners.</p>	<p>All firms, except the very smallest, provide considerable amount of detail on the governance structure of their UK audit firm. This includes composition, selection of board members, key partners on sub committees and the main topics of discussion at meetings.</p> <p>Some of the structures of the firms are very complicated and it is difficult to understand where key decisions are made.</p> <p>Overall length of the report does not seem to be a fact; these are as long as they need to be to cover the areas the firms wish to include.</p>
<p>A description of the internal quality control system of the transparency reporting auditor</p>	<p>Most reports contained useful information on the firm's policies and procedures. There was little evidence of firms continuing to adopt a minimalist approach, although in some cases more information could have been provided on leadership and HR policies and how they contribute to internal quality controls.</p>	<p>All reports, except the very smallest, provide considerable detail on the procedures and practices designed to deliver high quality audits.</p>

Requirement	2009 findings	2014 comments
	<p>Use of the AQF remains patchy, with only eight firms making an explicit reference to it.</p>	<p>Only five firms refer explicitly to the FRC's audit Quality Framework. However there is increasing evidence of consideration of the five drivers of audit quality as identified in the FRC's Audit Quality Framework. All but the very smallest firms cover the drivers which look internally at the firms; culture within the firm, skills and personal qualities of the staff and effectiveness of the audit process.</p> <p>The largest and medium sized firms address the reliability and usefulness of audit reporting.</p> <p>The largest firms also attempt to highlight the problems in the market but only one firm attempts to put forward their vision of the future of audit and how this might be addressed. These firms address the current issues in the market place, both nationally and at European level, which affect audit quality and how they are interacting with the Authorities to influence change.</p> <p>It is reassuring to see that although the drivers are not explicitly mentioned it is clear that the indicators are being addressed in the reports.</p>
<p>... and a statement by the administrative or management body on the effectiveness of its functioning</p>	<p>Thirteen of the reports included an unambiguous statement that the firm's management was satisfied with the effectiveness of its internal quality control system. Two others included statements which fell slightly short of an unequivocal confirmation.</p>	<p>The Transparency reports of all the largest firms contain considerable detail of the management / administrative bodies; how members are elected, the areas of responsibilities and the changes effected by them. However, only one report discusses shortcomings identified by these bodies and the changes to be implemented as a result.</p>

Requirement	2009 findings	2014 comments
<p>Confirmation that an internal review of independence practices has been conducted</p>	<p>Four of the reports stated explicitly that an internal review of independence practices had taken place, with two providing the dates of the review. None of the reports provided detail of exactly what the review had involved.</p> <p>A number of other reports included statements to the effect that independence processes were under “constant review”. We do not consider that this adequately meets the requirement.</p> <p>As last year, the remainder were either silent on the point or made reference to ongoing monitoring of compliance with independence requirements, such as annual confirmations of independence, audits of certain partners’ financial affairs or QA reviews of particular audits.</p>	<p>Very few reports failed to include an unambiguous statement that an internal review had taken place in the year. All reports now include details of the reviews that take place.</p>
<p>Financial information for the financial year of the transparency reporting auditor to which the report relates, including the showing of the importance of the transparency reporting auditor’s statutory audit work</p>	<p>We were disappointed with the quality of disclosures under this requirement in many reports. Information on non-audit services provided to audit clients was particularly lacking.</p> <p>In some cases information was lacking altogether, and in others it was organised in such a way as to make it difficult to make meaningful comparisons.</p>	<p>Only one firm failed to provide any financial information at all and seven failed to provide sufficient analysis of non-audit services. Amongst those firms who provided the information, the level of analysis of fees varied considerably.</p> <p>All reports contained details of the amount of revenue from the provision of statutory audit services but only half of these firms disclosed the level of fees arising from the provision of non-audit services to non-audit clients. Further, only three firms provided any analysis sort of analysis of this non-audit work</p>

Requirement	2009 findings	2014 comments
	<p>Two of the larger firms failed to provide any information under this requirement at all, apparently on the grounds that it was available elsewhere.</p>	<p>Four firms failed to provide comparatives for previous years.</p> <p>All firms (except two) falling within the scope of the Voluntary Code of Practice on Disclosure of Audit Profitability provided details of audit profitability within the transparency report. Of the two which did not provide the information one included a statement indicating where this information may be found. The other firm remained silent.</p>

Appendix 2 - List of Transparency Reports reviewed

Baker Tilly UK LLP
BDO
Begbies Chettle Agar Limited
BSG Valentine
Chantrey Vellacott DFK LLP
Chiene & Tait
CLB Coopers
Crowe Clark Whitehill LLP
Deloitte
Ernst & Young LLP
Everett & Son
French Duncan LLP
Grant Thornton
Hays Macintyre
Hazlewoods LLP
James & Cowper LLP
Kingston Smith LLP
KPMG Audit Plc
Larking Gowen
Littlestone Golding
Mazars
Menzies
Moore Stephens LLP
Nexia Smith & Williamson Audit LTD
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