

Financial Reporting Council

**Audit Committee Chairs' views on,
and approach to, audit quality**

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Executive Summary

The following executive summary outlines the broad views of Audit Committee Chairs (ACCs) during qualitative interviews.

Defining a good quality audit

Audit ‘quality’ can be perceived to be a nebulous term. Some prefer ‘robustness’ or ‘effectiveness’, as those words better communicate the important factors in undertaking a good quality audit. ACCs were asked to define a good quality audit and identified the following as being important: proper planning – alongside knowledge of the business and the specific sector – communication, and timeliness from the audit team. The lead audit partner also has a significant impact on perceptions of audit quality. It was not always clear that ACCs distinguished between a good quality of audit and a good quality of *service* from the auditor.

Selecting an auditor

Consistent with the 2020 research, ACCs start planning the audit tender 12–18 months before it takes place. The number of firms invited to tender often depends on the size of the business, as well as whether potential auditors have any conflicts of interest. Many ACCs commented on issues regarding limited choice of auditors due to the complexity or size of their business; however, there is a negative perception of joint audits solving this problem.

Key factors when selecting an auditor included the expertise, consistency, and professionalism of the audit team. Alongside these factors, ACCs commented that auditors should also have a broad understanding of the business, along with good chemistry and communication across their team.

Planning and executing an audit

ACCs tend to assess quality before, during, and after the audit. This assessment is made up of both formal and informal interactions alongside documentation and reporting. Surveys – of the firm’s senior leadership, Audit Committee, and the accounts function – are occasionally used by ACCs to gauge audit quality alongside audit reports – although the former were often felt to be too long and acted as more of a ‘tick box’ exercise rather than an activity of any added value.

ACCs commented on the importance of an auditor’s ability to build a rapport; it is also critical that they are able to offer challenge and show a healthy level of scepticism without being confrontational. It is key that a continuous and transparent communication style is adopted to enable firms and auditors to take both a proactive and reactive approach to issues.

Changes in the audit sector

Although ACCs were concerned about the potential impact of the pandemic, most were pleasantly surprised by the response from auditors. Working from home has brought forward technological advancements and ACCs have seen new processes being set up promptly. However, informal interactions were missed, as face-to-face ad hoc conversations often allow for a more transparent and proactive communication style.

There was a mixture of responses around what a 'proportionate monitoring regime' looks like, with some ACCs commenting that increased rules and regulations have made audits more complex and expensive, largely serving as a tick-box exercise which fails to identify 'bad apples'.

2020 research comparison

Among the main findings from the 2020 research, we found ACCs had different views and approaches to audit quality. The 2021 research largely supports this view again.

Other areas of consistency between the two years include the considerable emphasis that ACCs put on the audit tendering process; this came out strongly in both the 2020 and 2021 research. The experience of senior auditors, their firm and the team's history of delivering sector-relevant, quality audits again proved to be determining factors.

The 2020 research also demonstrated the importance of challenging auditors at the planning stage in order to ensure a quality audit. However, we saw less challenge in relation to both auditors' judgements, and in relation to company management during the audit process. Again, the 2021 research is consistent with those findings.

The 2021 research is also broadly consistent in terms of the key attributes that are valued in auditors. In 2020, the ACCs we spoke to indicated that audit quality centred on an audit team's ability to provide assurance of financial statements and, more specifically:

- their understanding of the business and the sector(s) in which it operates;
- their ability to identify key risk areas and appropriate mitigations throughout the audit;
- timelines for raising issues and completing work; and
- communication skills.

Regulatory standards and compliance with those regulations also played a key role. The application of these factors in auditor selection represent a significant step-up from what we might call 'mechanical audits', but in the 2021 research, the ACCs we spoke to were increasingly focused on the added value an audit firm can bring to the business over and above financial statement assurance.

Quality audits rely on a team that utilises the sector-specific knowledge garnered through previous experience to advise on leading practice for businesses, and deliver outputs which reflect these recommendations (e.g. application of benchmarking and providing input on business operations). In 2020, there were several hints toward this, with ACCs commenting that bringing an understanding of the sector's context was valuable, but the 2021 research indicated an increased emphasis on the advisory role that an audit team may fulfil. Firms that can convey their ability to add value beyond the audit itself are, in many cases, deemed more likely to be appointed than those who solely pitch their auditing credentials. It was also noted by the ACCs that this value should not come at the expense of a quality audit, nor should these additions be used solely to 'pad out' the final report, but rather be embedded at each stage of the audit process.

A notable difference between the findings from 2020 and 2021 centred around recent audit failures and the impact (or lack thereof) that they have had upon the tendering and appointment process. In 2020, there was significant media focus on scandals, such as Patisserie Valerie, BHS and Carillion, with these issues then playing a role in the judgement of the Audit Committee at the tender stage. While these audit failures may still give pause to ACCs, this year's research suggests that this hurdle can be overcome if the prospective audit team leaves a positive impression. If the lead audit partner has a strong track record in the sector, then the impact of (previous) high-profile failures by that audit firm is reduced – particularly if the partner is able to speak candidly about the issues experienced on problematic audits in which they, crucially, were not involved.

The research carried out in 2020 concluded that perceptions of good service from audit partners and their teams is closely linked to, and difficult to disentangle from, a high-quality audit. This sentiment was also observed in the 2021 research, but ultimately proved less of an issue as most ACCs we spoke to were able to differentiate clearly between good service (e.g. communication, sticking to timelines) and audit quality (e.g. planning, challenge).

Some opinions which have remained consistent include ACCs' preferences around timings when it comes to the tender process as planning for this exercise typically begins 12–18 months in advance of the commencement of the first audit. Though a minority of ACCs report otherwise, this is typically due to specific requirements from the business or audit firm itself, the size of the company and/or the state of the industry. The onboarding process was recognised as a time-intensive activity by a number of ACCs across the two studies. By keeping future business fluctuations in mind, and onboarding a brand new team of auditors well in advance of the first audit from an incoming firm, ACCs and management are able to build in time for the firm to get to know the business better before their work begins – which is beneficial to the wider audit process. Both studies also saw mention of how valuable the handover process can be for both the business and the audit firm if handled correctly; the incumbent firm being willing to meet with the incoming auditors often results in a far smoother transition.

How the tender process is run remains unchanged from the previous research, with the selection process beginning with businesses assessing the proposals of the firms invited against established criteria, followed by a presentation to the Audit Committee. In 2020, the presentation was deemed an opportunity for the audit firm to 'woo' the Audit Committee and demonstrate command of the elements that ACCs told us make up a good quality audit. Sometimes the top scoring audit firms would be invited to go through another round of interviews, often either with management or individuals from the finance team.

In 2021, one ACC summarised the process as ‘Choose who you’re going to ask to tender, receive proposals, assess the proposals, and you obviously have to define how you’re going to assess them, and that usually means the list of criteria and some sort of scoring system. They normally give you a written proposal and then you invite them in to present it to the Audit Committee members. You’re normally just devising a scoring system that each Audit Committee member completes.’

Turning to the audit process itself, in 2020 it was clear that ACCs utilised both formal and informal communication channels when engaging with their auditors. Audit Committee meetings and the pre-planning meeting were the key means of formal feedback and were held via video conference platforms during the pandemic. Informal phone and video calls would take place roughly once every 4–8 weeks and were relied upon to check on progress and get an early read on concerns, with the frequency of both these formal and informal meetings increasing as the audit evolved. Across the board, timely and clear communication of issues was seen as a key indicator of audit quality. The methods of contact have carried over to the 2021 run of this research due to the ongoing pandemic, and despite many having initial worries about the lack of face-to-face contact, most have been pleasantly surprised by how effective and regular the online communication has been.

With regard to the end of the auditing process, there is a consensus across both years that audit reports are becoming overly long, and that often there is little tangible difference between the reports from the auditors and the Committee – which means that time-poor stakeholders are unlikely to take adequate time to digest them both. As audit reports have become more standardised, a few commented that they have also become generic and tick box, which can lead to meaningful and useful data being left out of the final report due to some nuances not seeming to adhere to any one category or box.

Following on from this particular topic, the 2020 research showed that the majority of ACCs had an awareness of Audit Quality Indicators (AQIs) but rarely used them unless they were relevant to the business in question. This is consistent with the 2021 findings. When asked how AQIs could be more useful, the feedback was similar across the two years; ACCs have an appetite for historical comparison and of-the-moment trends, so sector-specific AQIs would be more valuable than generic indicators.

Background

The Financial Reporting Council (FRC) regulates auditors, accountants and actuaries, and sets the UK's Corporate Governance and Stewardship Codes. As the Competent Authority for audit in the UK, the FRC sets auditing and ethical standards, and monitors and enforces audit quality.

Audit Committees can play a vital role in guaranteeing audits are conducted to high-quality standards and the FRC therefore routinely engages with Audit Committee Chairs (ACCs) to inform its work. The FRC is keen to further its understanding of ACCs' views on, and approach to, audit quality, and commissioned YouGov to conduct 50 one-to-one interviews with ACCs in order to explore this subject.

The following report outlines the key findings from this year's research, comparing and contrasting with last year's findings (in which YouGov interviewed 50 other ACCs). Additionally, YouGov retained expert advisors from the audit sector to review this report and to bring context from the wider audit landscape.

The audit landscape in 2021

The FRC's Annual Audit Quality Inspection Results for 2020/21¹ showed that nearly one third (29%) of audits inspected by the FRC still require improvement, with 71% assessed to be of a good standard or requiring only limited improvement. Overall, 'quality across firms was mixed'.

Recent failings in audit have highlighted 'the need for a new approach' by some in the industry. For example, in this year's research, Grant Thornton's fine in connection with mismanaging the Patisserie Valerie audit was commented on by ACCs. Since 2020, the collapse of high-profile companies, such as BHS and Carillion, has also given rise to wider public and political concerns about the efficacy of audits, resulting in multiple independent reviews into the sector, concluding with a White Paper on 'Restoring trust in audit and corporate governance'.²

ACCs are acutely aware of the issues:

¹ <https://www.frc.org.uk/news/july-2021/frc-annual-audit-quality-inspection-results-2020-2>

² <https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms>

I haven't seen enough root cause analysis. So, take Patisserie Valerie, take Carillion, take BHS. What should have happened that didn't happen? And we don't seem to be learning from our mistakes, we don't have a black box mindset of thinking. I don't see that from the regulator, and I don't see that from audit firms, and I would like to see that. That's what happens every time. Why did it crash? What must we learn? We mustn't let this happen again. When you think about all those BHS pensioners, the very least they would want is for us to learn the lessons so it doesn't happen again. – ACC, FTSE 250

'Restoring trust in audit and corporate governance' (March 2021)³

The government's White Paper was written in response to recommendations from the independent reviews listed below. The White Paper recommended that the FRC should be replaced with a new independent regulator that aims to advance innovation, anticipate audit risks and promote quality improvements.

Sir John Kingman's Independent Review of the Financial Reporting Council (December 2018)⁴

Kingman's review continues to be relevant for this year's research. Sir John Kingman's review focused on the role of the regulator. The review recommended that the FRC be replaced with a new independent statutory regulator, accountable to Parliament, with a new mandate, new clarity of mission, new leadership, and new powers. The new regulator would be called the Audit, Reporting and Governance Authority (ARGA).

Competition and Markets Authority (CMA)'s statutory audit services market study (April 2019)⁵

The CMA's review focused on the audit market, identifying problems with competition, choice and resilience that were adversely affecting audit quality. The review made various recommendations to address these problems, including mandatory joint audits, an operational split between the Big Four audit firms' audit and non-audit businesses, and greater regulatory scrutiny of Audit Committees.

³ <https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms>

⁴ <https://www.gov.uk/government/publications/financial-reporting-council-review-2018>

⁵ <https://www.gov.uk/cma-cases/statutory-audit-market-study#final-report>

Sir Donald Brydon's independent review into quality and effectiveness of audit (December 2019)⁶

Sir Donald Brydon's review focused on how the audit process and product could be developed to serve the needs of users and the wider public interest more effectively. The review made various recommendations and suggestions. These included recommending that Audit Committees invite shareholders to suggest areas for the audit plan, Audit Committee Chairs (ACCs) negotiate the audit fee, and Audit Committees publish a three-year rolling Audit and Assurance Policy as well as minutes of their meetings.

⁶ <https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review>

The research

Following previous quantitative surveys⁷ and qualitative interviews with Audit Committee Chairs (ACCs), in 2021 the FRC commissioned YouGov to deliver 50 qualitative depth interviews with ACCs of Public Interest Entities (PIEs⁸) to explore ACCs' views on, and approach to, audit quality.

Aims

The overarching objective of the interviews was to provide the FRC with a rich understanding of ACCs' views on, and approach to, audit quality and to compare and contrast findings with the 2020 YouGov Research.⁹ The interviews explored the following areas:

- Defining a good quality, and a poor quality, audit;
- Planning and executing an audit, including evidence gathering and communication with auditors;
- Reporting on audit quality;
- The audit tender process;
- Changes in the audit sector, including familiarity with AQIs;
- The future of the FRC, and as it transforms into the Audit, Reporting and Governance Authority.

The FRC intends to use the findings from this research to inform its ongoing work, including further reforms to the audit sector and its relationship with other regulators.

A full technical appendix, which outlines sampling, discussion guide, analysis and reporting, is included at the end of this research report (from page 46).

⁷ 2013, 2016 – Confidence in Audit (Qualitative report); 2015, 2016, 2017, 2018 – Survey of Audit Committee Chairs assessing the state of audit (series of Quantitative surveys); 2016 – Reputation Study of Key Stakeholders (Quantitative survey).

⁸ The definition of a PIE is as originally set by EU audit legislation, now translated into UK law, and the subsequent UK classification of such entities is currently: UK entities with transferable securities (equity/debt) admitted to trading on a regulated market in the European Economic Area (EEA); Credit Institutions, irrespective of whether they are listed or not; and Insurance Undertakings.

⁹ <https://www.frc.org.uk/getattachment/33a3b6e1-958a-4212-95c8-8aca6dd1b183/YouGov-ACC-Research.pdf>

Defining a good quality audit

An important starting point for any discussion of audit quality is that ACCs did not always use the term 'quality'. ACCs instead referred to terms such as 'effectiveness' or 'robustness', as this aligns closer with the criteria they use to assess the auditors, such as their level of technical skills and ability to communicate clearly. The idea of 'quality' appeared to feel nebulous to some and is not always discussed explicitly in their reporting.

We rarely use the words 'quality audit' in our day-to-day deliberations ... The word 'effectiveness', I suppose, is more of a proxy for quality ... We don't sit there and say, 'How was the quality of that audit?' It's just a word. You look at it, but we're using different terminology. – ACC, FTSE 250

If I were to summarise [quality] in a word, I would say 'robust'. – ACC, FTSE 100

Leaving aside the issue of terminology, the key words that are top of mind for most ACCs when thinking about quality (or, effectiveness) in audit are 'independence', 'challenge', 'scepticism' and 'firm judgement'.

You know, if you have a client who pays you five million a year in audit fees, you think very carefully about whether you want to upset that client by insisting they have to provision or disclose something ... Independence of spirit and independence of analytical investigation, and the required toughness you have to have, is quite an important aspect of a good audit. – ACC, FTSE 100

The research found that there are a number of inputs into ACCs' perceptions of audit quality. To begin with, proper planning on the part of the auditors was seen as a critical feature of good quality audits in most of the interviews we carried out. Planning allows the audit team to identify potential problems in a proactive way, rather than having to react to unforeseen issues.

[The auditor needs to have] an understanding of the business, to start with... We need good planning of the audit and identification early on of the key areas of audit. And then good project planning, so that they project plan it all the way through to the end. – ACC, FTSE 100

To get the best out of it, you need the teams to be talking in advance, pre-planning it, robustly sticking to what can be provided early in the game, what can be done way in advance of the year-end, right, to help the audit operate efficiently. – ACC, Other listed equity

A good quality audit is one that is properly and effectively planned, taking into account a good understanding of the business, understanding of the financial statement risks within that business. – ACC, FTSE 250

*We need good planning of the audit and identification early on of the key areas of audit.
– ACC, FTSE 250*

I think, first of all, [a good quality audit] is one that is appropriately planned to address the needs of the entity that it's serving, that planning is being properly communicated to the Audit Committee in advance of the audit starting, updates are given between the course of the audit and the Audit Committee getting the final report. – ACC, Building society

As in 2020, ACCs commented that the audit team and, in particular, the lead audit partner, tend to be the key drivers of quality, rather than their respective firm's governance or culture. Critical attributes that ACCs want in the lead audit partner include, but are not limited to:

- an in-depth understanding of the business being audited;
- an understanding of the sector with knowledge of the emerging themes and developments relevant to the sector;
- the ability to identify the key risk areas;
- timeliness in terms of raising issues and completing the audit on time;
- the ability, and necessary degree of integrity;
- the capability to communicate clearly throughout the audit.

The particular audit 'brand' is perceived as relatively unimportant in driving audit quality provided that the firm has suitable capacity, including the international network that may be needed. Global scope is, understandably, of particular importance to ACCs at the larger companies we spoke to.

It's down to the quality of the staff involvement and the relationship that they can build with you and you with them, and that starts at the top, with the partner, and the level of trust you can build with the partner, not only as the audit chair but also the CFO with the audit partner as well ... [T]hose personal relationships, I think, are exceptionally important. The audit firm needs to have spread in terms of its own skills to cover the challenges within my business, and not only within the industry that I'm working in but also within the geographic reach that I'm selling to as well as operating in. – ACC, FTSE 100

The other thing that's important is that we feel that the people who are doing the audit are also very much keeping abreast of what's going on in the wider market ... there's a lot of change coming so [we want] people that are close to that, both in terms of what's happening in the audit world but also what's happening in the insurance world or financial regulation, more generally ... that sense of being current and up-to-date is important. – ACC, Insurers

I need a firm who have detailed, relevant knowledge of the sector, which in financial service is a bit more complicated than a number of other sectors ... They have to have the resources to conduct an audit, which sometimes can be global ... And then the audit partnering team need to display sound judgement. – ACC, FTSE 250

I want an auditor who knows that they are working for the Audit Committee as the representative of the shareholder. I also want an auditor who will never sit on the fence ... I want the auditor to talk to me about the business ... I want the auditor to ... talk to me about what they are seeing in the business, and what is of concern to them. – ACC, FTSE 100

The 2020 research also found that late surprises can have a considerable impact upon perceptions of audit quality, and this theme re-emerged in the 2021 research even more powerfully, with ACCs at a wide variety of companies relaying this particular issue strenuously, and often, to us. The pandemic may be the driver in making this issue more pronounced in 2021.

Overall, ACCs are not averse to hearing bad news or having their views challenged as long as it is brought up in a timely manner and allows all parties sufficient time to decide on the response.

What you don't want is to go into the Audit Committee that's reviewing the half year or full year results and find there's a surprise ... When they have to go back and get a concurring partner review or sign-off on a particular aspect of the accounts, sometimes the other partner, who's not on the job on a daily basis, ... they may ask something that our team didn't anticipate and then it kind of throws everything out of kilter. Because you're planning to release your results in the next 24 hours and they're still examining a topic due to somebody asking a question that they didn't anticipate, and their audit team didn't anticipate. That's a sign of an audit that was probably poorly planned and the work was not directed well. – ACC, FTSE 250

I'd much rather people actually told you stuff and flagged it in advance and then helped us to manage it, rather than just have a surprise in a meeting and then it's daggers at dawn at the last minute and you've got to pick something. – ACC, Insurers

A good quality audit is one where there are no late surprises ... We need to stop finding things at the last minute. – ACC, Other listed equity

Fundamentally, quality is often intrinsically linked to the outcomes of the audit: the audit determines that a company's financial statements provide a true and fair view of the company's performance.

I think my definition is probably different from the FRC's ... The FRC looks at evidence in audit files to say whether they've got a good audit or not. I'm interested in the outcomes ... [M]y definition of audit quality is, at the end of the day, 'Are the outcomes the right outcomes?' And will somebody coming along look at this and say, 'I don't believe this is the right outcome, I would change the audit opinion?' – ACC, FTSE 250

Differentiating between 'good service' and 'a high-quality audit'

The research carried out in 2020 found that, ultimately, good service from audit partners was closely linked to a high-quality audit for many of the ACCs. Although we found some of this sentiment again in 2021, it seemed to be less of an issue.

I don't think there's really much difference, no. I can't see myself saying I've had a good quality audit, but the service has been rubbish. I wouldn't have had a good quality audit if the service had been rubbish, to me they're almost together. – ACC, Other listed equity

Most ACCs we spoke to felt they were able to differentiate between good service (e.g. communication, sticking to timelines) and audit quality (e.g. planning, challenge).

I think there is [a difference], because there are two different issues. The service is really – is the audit done in the time frame that it needs to be done? ... And then, secondly, you see the quality of the audit work by the challenges and the questions that are reported back to the Audit Committee, because if they came back with no issues and no problems, and didn't report on anything, we would be worried about whether they were carrying out their job properly. – ACC, Building society

I think they've got three or four aspects when defining a good quality. Obviously, the quality of the audit, i.e., what was the quality of the challenge, the quality of your dealings with the auditor, how did they challenge you, what evidence do they seek, etc? Did they just accept what you said at face value? Then, we look at communication, timeliness of communication and degree of pre-syndicating any issues. How were they escalated, how were they discussed? Finally, how did they record the conclusion and the timeliness of the work they've done. Then, we also ask them about the quality of the people they interact with too. Do they know what they're doing? Are they briefed on what [the company] does? And are they knowledgeable about banking audits? So, we cover a fairly wide universe.

– ACC, FTSE 250

Yes, there is. They're linked, but the quality of audit, I think, includes those issues of looking into things in depth and making those challenging observations, and thinking about the audit plan and how it fits with your particular company. Whereas audit service, I think, includes issues like ... how good were they at managing the timetable? How good were they at organising the stock-takes, you know? How did they interface with the company? ... [D]id they make good use of management time when they did so? So, I think they're linked but they're not necessarily the same thing. – ACC, FTSE 250

Selecting an auditor

Overview

ACCs spoke to us at length about their auditor selection processes and the factors that were important to them when seeking to appoint an auditor capable of delivering a high-quality audit. These factors were largely consistent with the findings from 2020, with the experience of the senior auditors (partners and directors) and both the firm and the team's history of delivering sector-relevant, quality audits proving the determining factors once again.

The majority of the ACCs we spoke to had undertaken an audit tender within the last five years. The remainder had all either conducted audit tenders in the past (but more than five years ago) or were about to embark upon the process in the coming year.

The tender process is typically planned around 12–18 months in advance (or more for larger businesses); this timeline is deemed sufficient for the requisite 'cooling-off' period, and to allow time to see presentations from the range of bidding firms (the number of which is often dependent on the size of the organisation, with larger businesses receiving fewer tenders). On average, most businesses invite around three to five audit firms to bid.

Other factors influencing the pre-tender timelines include the state of the business at that time, with one ACC commenting that *'One needs to keep in mind what is the least bad time to do an audit [tender]? By that, I mean I don't know a business that's not in a state of change at the moment'*, suggesting that ACCs and management often have to keep future business fluctuations in mind where possible when onboarding a new audit team. It was also noted by some that onboarding auditors in advance of the start of the audit allowed them to get to know the business better before their work began.

This was consistent across both the 2020 and 2021 iterations of this research, with the onboarding process being recognised as a time-intensive activity by a number of ACCs across the two years. On this note, there were some unprompted mentions of how valuable the handover process can be for both the business and the audit firm if handled correctly; the incumbent firm being willing to meet with the incoming auditors often results in a far smoother transition.

The process for running a tender was fairly consistent across participants; most outlined a three-stage process regardless of their company's sector or market listing:

1. Deciding who to invite
2. Selection process
3. Decision

The tender process

Deciding who to invite involved developing a shortlist based on:

- whether any firms had conflicting interests;
- who the incumbent auditor was; and
- whether firms had the relevant expertise.

The selection process begins by assessing the proposals of the firms invited against established criteria, followed by a presentation to the Audit Committee.

There are various problems with the amount of choice in the tendering process. Many ACCs are limited to a small number of audit firms to select from due to the size of their company, complexity of business, and sector (e.g. banking). Though businesses highlighted their frustration at the limited choice, they felt that joint audits would be impractical for a number of reasons. First, this regulation is seen by some to strip audit firms of their autonomy, as well as their ability to exercise their own judgement and to avoid any conflicts of interest. It is also perceived to be 'highly expensive' for all parties involved and has the unfortunate side effect of actually narrowing the market, as there are now two firms who are unable to be used for wider consultancy work.

I strongly dislike joint audits, or audits where you have to outsource part of it to somebody else because there is no idea about the quality of the audit and I do have experience of auditing in France, which has always had a requirement to have joint audits and they generally have one big firm and one pint-sized firm, and the pint-sized firm is clueless. So I don't agree with the idea of two firms of auditors or a big firm and a little firm, in these circumstances. – ACC, FTSE 250

I'm completely against the idea that you should force companies to have joint auditors. One of the reasons you appoint an audit firm is, 'Have they done something this big before?' Well, there are four big firms, if you don't give five, six, seven, or eight the chance to work on a big audit they'll never be able to show they've done it, right? So, if you force a firm to appoint one Big Four and one of the others, then you'll start to get the others learning how to do the big audits. Great in theory. In practice it has several constraints. – ACC, FTSE 250

If you've got a big IT integrator where all of the Big Four are going to want lucrative consulting IT integration work rather than an audit, then obviously that integration company is then forced to look outside the Big Four and might argue it doesn't have enough choice.

I think those circumstances are pretty limited, and the Big Four were formed for the purpose of providing consistent global quality to large complex global organisations. I don't think that the proposals in the consultation paper will help these firms grow and compete, because I think that if any of those firms are doing a substantial portion of the audit, then whoever is the group auditor will want to go and meet the management and review the audit work papers and do some re-performance work in that significant area, particularly if any of the significant group risks are within that area. – ACC, FTSE 250

There is an overarching pessimism about the prospect of the landscape opening back up to include non-Big Four firms:

To my mind, we're long since past the time we should have been talking about choice amongst the accounting firms. We should have done it when it was the Big Seven or the Big Eight. – ACC, FTSE 250

Now we've got this Big Four, who are really the only firms capable of certain types of audits, and I don't really think that's easy to change. – ACC, FTSE 100

We've tried, on a number of occasions, to try and involve others outside of the Big Four in the audit tender process. But unfortunately, when we've come to look at what the key things that they need to be able to do, they just haven't had the coverage that we need. And whether that is global coverage, whether that is experience in, for example, US bond markets. Therefore we've struggled to involve them in tenders. – ACC, FTSE 250

ACCs at large businesses often felt that they were limited to only inviting the Big Four due to the firms' capability to manage large-scale audits, in terms of both their international reach and internal capacity. Capability, in the form of resources and capacity, proves an issue for smaller firms, particularly as the FRC has put in place more rules and regulations, making tenders and audits more time-consuming and expensive. This is further exacerbated by the issue of global coverage, with international businesses requiring firms with a similar reach. This 'oligopolisation' of the Big Four has therefore meant that smaller firms often decline to tender for the audit of larger businesses, despite a minority of ACCs reporting that they have 'been told' to invite a second-tier firm.

First of all, you have to do your own due diligence on whether or not you feel that firm could provide you with the services that you need, and I've already mentioned one key factor, which is international spread, and so there are quite a few firms that immediately you would not invite to tender because it's just a waste of their time and a waste of your time: they can't provide the services that you need. – ACC, FTSE 100

Outside the Big Four, in my experience, the firms don't have the same ability to maintain quality across as many countries as the Big Four can. – ACC, FTSE 250

However, these larger firms have themselves been known to turn down invitations due to lack of capacity or capability – and some ACCs felt that this has been further worsened by the Covid-19 pandemic. Larger businesses also face the issue of some Big Four firms preferring to take up consulting work or provide remuneration advice, deemed 'more lucrative and interesting' by some of the ACCs interviewed. Competition is cut down in this regard, with firms seeing consultancy services as a kind of commercial imperative, which favours not involving themselves in external audits, particularly if they are already embedded within a business, and may have to go toe-to-toe with other Big Four firms for the audit contract.

Though some ACCs suggested they could do little in response to this trend, a handful have implemented a 'soft rule' of sorts, which allows only firms who tender for audit to be considered for consulting work. This serves as an incentive for firms to put themselves forward and avoids ACCs of larger businesses being left with just one or two of the Big Four to choose from.

So, just say, you've got PwC performing the audit, you've got KPMG performing internal audit, you've got Deloitte doing your remuneration advice, okay? Any of those other firms that you want to come to the tender are going to have to give up their contract to do non-audit work before the result with the tender, unless you hold the tender at least a year in advance. That seems to me, it's just the way the rules make it work, but if you went out to the firms that are doing the non-audit work and said to them, 'How do you feel about giving up your non-audit work and taking a one-in-four chance of winning the audit?', most of them would probably say, 'No, thank you', and meanwhile, what does the company do to get that non-audit work performed? – ACC, FTSE 250

Some ACCs believe there is a moderate amount of concern held by firms around the risks of taking on audits for larger (or more volatile) businesses, especially in light of some of the recent audit failures – and this extends to both the Big Four and non-Big Four firms. Despite these issues, however, the Big Four largely enjoy a strong reputation amongst this audience, with one ACC describing them as 'really a proxy for quality', with others echoing this sentiment.

I am absolutely confident that the quality in the Big Four is absolutely sufficient. Now we've tried, on a number of occasions, to try and involve others outside of the Big Four in the audit tender process. But unfortunately, when we've come to look at what the key things that they need to be able to do, they just haven't had the coverage that we need. And whether that is global coverage, whether that is experience in, for example, US bond markets, certain M&A experience, they've not had that. – ACC, FTSE 100

You know, the FRC do their annual quality reviews, we review those. And obviously if one of the audits of the company concerned is subject to those reviews then we'll look at that as well. But as a general point, yes, we do look at the annual results of the FRC's annual audit quality reviews. Well, I think, I mean, there's an awful lot of change going on in that space right now in terms of the governance of the audit firms and how that's all being set up. I suppose my starting point on that would be that I think it's almost inconceivable, particularly with any of the Big Four firms, that their governance is going to be set up in a way that is not compliant with the FRC governance code. So I take it as read that they are compliant. – ACC, FTSE 100

There seems to be a step-change taking place where ACCs and management are seeking 'fresh blood' when inviting firms to tender, and are taking the forced rotations as an opportunity to work with new firms to innovate systems and adhere to/adopt best practice. Many ACCs stressed that audits should not be just about providing a true and fair view of the company's finances, but also using knowledge of the sector to advise on how the business might improve itself – for example, an audit team with strong tech sector experience advising on best practice for the company they are currently auditing, based on previous learnings. Firms which can convey their ability to add value beyond the audit itself (i.e. through benchmarking and input on business operations) are deemed more likely to be appointed than those who solely pitch their auditing credentials, but, crucially, this must not come at the expense of a quality audit, which is the determining factor for the vast majority.

We would draft a brief for the tender in terms of what we were looking for, and as well as timing and administration and that stuff, what are the qualities we are looking for? Whether it is team size, nature of team diversity, whether it is numbers of people, how we wanted the audit to be organised if we had a view, and what the key issues are that we wanted them to focus on or to talk to us about, and any process questions we had, such as around the use of IT or data analytics etc. We would then invite the firms to go through a period of reviewing data from us, whether through a data room or provided to them through a period of interviews and meetings with various members of management ... We would assess them on that, and along the way ... we would have our mind on audit quality. – ACC, FTSE 100

If people have had issues, usually we are well onto it, to addressing those, and we're actually looking at what fresh approach they are bringing to the audit, because the point of tendering is to bring some fresh views and fresh blood into it, and a different level of understanding and challenge. So we like to see what the different approaches are, and that's what we're contrasting. I still believe that the audit isn't just about assurance. It should also be a business improvement opportunity, and the observations that the auditors make, we can learn from best practice in other organisations. As an audit chair, I want to hear what the company could do better. Not just on financial control and reporting matters, but business operations. I mean if they spot something wrong with the way we're operating our supply chain, I'd rather hear about that. If they've done audits of other tech companies and they're seeing things that other tech companies do which we don't, they should go, 'Why aren't you doing that, which is common practice in these three companies?' And so I want to hear that as well. So we also look for whether the auditor has got good knowledge and good experience of either other competitors, or other similar industries to us. So we like to see what the different approaches are, and that's what we're contrasting. Obviously, we look at, 'Is the audit partner who is going to be the lead on it knowledgeable about the sector?' – ACC, FTSE 100

Choose who you're going to ask to tender, receive proposals, assess the proposals, and you obviously have to define how you're going to assess them, and that usually means the list of criteria and some sort of scoring system. They normally give you a written proposal and then you invite them in to present it to the Audit Committee members. You're normally just devising a scoring system that each Audit Committee member completes.
– ACC, Other listed equity

Key criteria for selecting an auditor

As in other areas of the audit process, there is a role for structured criteria, but ACCs often rely on the 'look and feel' of the presentation delivered by the prospective audit teams, rather than placing emphasis on a structured assessment of attributes. This was prevalent among the ACCs who had previously been employed by or were a partner at an audit firm, rather than those taking up the role after a prolonged stint as CFO, for instance. Some recurring phrases used by ACCs when describing the audit team (including senior managers) revolved around strong and relevant sector expertise, consistency, and professionalism.

So, it's not just the glossy brochures or the presentations. I think the presentation and, again, it's that meeting the partner, the key people, all comes into play. – ACC, FTSE 250

Most ACCs cited the lead partner as the key criterion when selecting an audit firm. A few ACCs mentioned their desire to know whether the lead partner would be conducting the actual audit, or whether their name was on the bid just for the ‘pull’ (as was noted in 2020). Indeed, if the lead partner was not deemed appropriate for the job, some ACCs had no qualms about asking for a change in personnel that had been proposed by a prospective audit firm or dismissing a bid outright. The dynamic with the lead audit partner is also key; since the outbreak of the pandemic and the move to remote working, the relationship between the ACC and the lead audit partner has (in some cases) seen a shift from a fairly informal one, wherein the two individuals could discuss challenges over coffee, to something slightly more structured.

It's partnership. It's, you know, we're working for the common cause. So, you know, it's got to be professional; I'm not a fan of auditors and chairs of Audit Committees socialising at highly expensive things, and things like that. I think there's a line to be drawn, especially when you're a listed company, but I am a fan of audit chairs and senior partners, and lower levels throughout the company, getting to know their counterparts.

– ACC, Other listed equity

Another important criterion was the wider audit team. Some ACCs talked about the importance of seeing ‘chemistry’ within the audit team and between the audit team and company management. There were unprompted mentions of the need for junior auditors to be highly enthusiastic about both the audit itself and the sector within which the business operates, which ties into the requirement for members of the team to have direct experience auditing within the company’s sector. A majority of ACCs also mentioned the fact that a bidding firm was more likely to be successful in winning the audit if, at the proposal stage, they confirmed that the appointed team would perform the audit year-on-year. An audit team that is seen to be restructuring each year is looked upon unfavourably, as this prohibits strong relationships from being formed between the parties involved.

When assessing a prospective audit team, ACCs will look at the track record of the individuals in front of them, what internal quality control assurance processes are in place within the firms, as well as the direct experience of the partners/director-level staff. Teams are routinely and specifically questioned on how they ensure a high-quality audit, and how they ensure resolution of differences of opinions. The tender process also relies on having the bidding auditors explain how they might go about challenging management, and how issues may be escalated to those charged with governance. Responses to these questions are partially scored against the aforementioned criteria, but the attitude of the auditors plays a key role in convincing the committee.

Some ACCs mentioned the audit fees as a potential factor in their decision, but generally it appears they were not a primary determinant in the final decision for many (if any). Ultimately, the price of an audit was often seen as a necessary expense, although a minority of ACCs mentioned that audits were getting more expensive.

Technology was mentioned sporadically in the interviews. While clearly seen as an important factor by some ACCs when selecting an auditor, it was not always a deciding factor. The Big Four were lauded for the impressive array of technology and tools they employed compared to the second-tier firms, though some ACCs have begun to see this almost as 'housekeeping' for firms of their size/calibre.

In talking us through their tender process, many ACCs stressed their independence from company management – even if management was involved at some stages in the process – and the scrutiny the ACCs undertook of the prospective audit firms. Some ACCs were keen to point out just how much due diligence went into their selection process in an effort to avoid any conflicts of interest. There appeared to be a detectable element of self-regulation at play in the selection process on the part of some ACCs. This issue of independence was also emphasised by the ACCs who had previously worked as audit partners, with some refusing to personally assess proposals from their legacy firms, and instead leaving the decision to other members of the committee. For those to whom this did not apply, they stressed the importance of leaving aside any bias towards the firm(s) they previously worked for – though positive track records of lead audit partners could prove a persuasive factor in making the decision.

Whilst recent audit failures can give pause to ACCs when looking to appoint a new auditor, this is a factor that can be overcome if the prospective audit team leaves a positive impression. If the lead auditor partner has a strong track record in the industry, the significance of scandals or difficulties is often easy to downplay – particularly if the partner is able to explain previous issues and how they were resolved. On a similar note, Audit Quality Reviews (AQRs) and transparency reports were not used by more than a small proportion of the sample group, unless the review was relevant to the business in question. This audience reported having access to a great deal of paperwork associated with audit and this, along with the reported changes in regulation, has resulted in a reluctance to have more information to read/absorb.

All it's going to do is create tons and tons and tons of documentation, and at the end of the day it's still not going to stop the two rotten apples in the barrel that cause a problem. So, better to focus on how do you improve people's behaviour than trying to come up with reams of documentation on risks. – ACC, FTSE 250

*Not proactively, no. Well, we don't look at those reports unless there's something very close to home, but we certainly expect the firm to have its own governance, absolutely.
– ACC, FTSE 100*

A handful of ACCs were actually part of the pilot scheme currently running to update the key AQIs to measure audit quality. The ACCs who were part of this pilot scheme were unsurprisingly more familiar with the existing commentary/documentation on audit quality than some of their counterparts, though there were exceptions to this. The use of AQIs will be outlined in more detail in a later section of this report.

So we've actually been looking quite hard as an Audit Committee on, what are the key AQIs that help us to measure audit quality? And we're just, literally, kicking it off because we're doing it for this current year. But that's been quite an interesting conversation about what are the measures out there. So we've had a talk amongst ourselves about how do we think we measure as an Audit Committee? What are the things that help us to measure quality? – ACC, FTSE 100

Planning and executing an audit

Overview

Once an audit firm has been selected, ACCs claim that they assess quality before, during and after the audit process. This starts with the planning document, which outlines the methods auditors will use. Formal reporting is relied upon alongside informal interactions with the auditor.

During the planning and executing phase, communication was one of the key factors when assessing quality. As well as having transparent communication, it is also important for firms to be both proactive and reactive if issues arise during the process. ACCs emphasised that how auditors react to problems is an important factor – auditors highlighting a problem or issue late in the audit process is a particular problem indicated by some ACCs, and that being open and timely in the face of issues is critical. These delays can then have a knock-on effect on their own work.

Though there is limited formal interaction between the ACC and the auditor, some businesses produce a questionnaire, which they feel allows them to discover and give feedback on issues following on from the audit. ACCs highlighted that these questionnaires could focus on quality more explicitly. ACCs also have informal chats with the auditors to discuss issues, which was more straightforward pre-Covid.

During the audit process, auditors are expected to build a rapport but also challenge findings, without creating excessive conflict. It is important that the relationship is ‘not too comfortable’ as auditors often need to ask ‘awkward’ questions. Challenges arise primarily in the planning phase around scoping the audit and in the evaluation phases, particularly when the auditor reaches a different judgement than management.

ACCs generally felt that there was sufficient guidance and standards around assessing the audit; however, some felt that there are excessive rules and regulations, which often feel like a tick box exercise and does not necessarily indicate bad practices within the audit process.

A good quality audit is that response to the environment of the auditee, rather than some standard formula. – ACC, FTSE 250

I think what's as important as the issues themselves is how the firms then respond to those issues and improve their practices and learnings. It's about how the business responds, learns and improves ... I think that's as much as what I would look for as the underlying issue itself. – ACC, FTSE 100

Evidence used in assessing audit quality

According to one ACC, ‘A good quality audit is determined by the quality of the questions and the persistence of the questions, and the digging into the items which are under review’ (ACC, FTSE 100). Those persistent questions – and, therefore, the focus on quality in audit – run through the whole audit process, from the planning stage through to signing off the accounts.

We invite our auditors to every Audit Committee meeting. And they are asked to update us, first of all to present their plan, and we discuss their plan with them, but then to update us at each meeting on the issues that are arising as they arise. We also ask them to participate and invite them to participate, and they do participate in our internal audit meetings. So they are a part, and they see that process and what our internal auditors are doing. – ACC, Other listed equity

Nearly every ACC we spoke to emphasised the critical importance of ongoing communication between themselves and the auditors (or, more specifically, the lead audit partner). Most ACCs invite their auditors to each of their committee meetings, as doing so helps to ensure openness and transparency, and alleviate, or at least minimise, the issue of last-minute surprises.

A board’s role is episodic. You know, our job is when we’re meeting. So, I would not expect a blow-by-blow of the audit. What I do expect, is there to be good planning and good, periodic, and timely reporting back. – ACC, FTSE 250

Compared to even a few years ago, we have pretty regular dialogue now, with the auditors ... very open and transparent about what’s going on. And I think that also is part of, ultimately, assessing is this audit doing what it should do? Is it giving us, therefore the shareholders, comfort? – ACC, Insurance

At every Audit Committee we get an update, so the audit partner joins the meeting, in fact he joins the whole meeting, so he sits in on the whole agenda. And has a slot to give an update. And I think we’ll continue that. It’s been invaluable for the first-year audit. – ACC, Building society-listed debt

ACCs are looking to have regular interaction with auditors to ensure there is transparency in the process. Evidence of transparency can be revealed through both formal meetings and informal interactions.

You take your opportunity to spend time with the auditor without executive management present, and so ask very direct questions as to whether the management have been helpful and whether the auditors feel in any way that management have been trying to keep them out of any whatever, pull the wool over their eyes, or whatever. So, there are different tools at your disposal. – ACC, FTSE 250

There's all the subjective things that you can't write down but you get a feeling for and that's the strength and depth of the team that run the audit so, when we have our formal meetings with them, and indeed our informal meetings, if we ask questions of the team, do we get an answer there and then? Do they know it? Or do they have to say, 'Oh, well, we need to come back to you on that one.' And the more they are on top of it and give answers that feel right and that the management, if they're in the room, are confident of as well, then that gives a lot of comfort that they actually do know what they're doing and they're on top of it. – ACC, Insurers

Aside from the Audit Committee meetings, some ACCs told us that they also look for evidence of senior involvement from the lead audit partner throughout the course of the audit. This report has already commented on the importance of the lead audit partner in ACCs' perceptions of quality, and knowing that the most senior member of the audit team is fully engaged in the process offers considerable comfort.

You're looking also at the range of interaction between the senior team, to what extent do they stay involved, and to what extent they delegate everything down to relatively junior staff. – ACC, FTSE 250

I would say the audit manager and partner speaks with a tremendous amount of authority and gravity, and they are a very highly thought of individual. So, that does help us have a lot of confidence. – ACC, Building society

In addition to the communication and interaction with the auditors, ACCs are also liaising with internal teams to assess audit quality and to ensure that the auditors are asking the right questions.

*We rely a lot on our own accounts team. We debate the key accounting judgements at some length, and then we check the reasoning. You know, do we think what [the auditor] might have told us was reasonable? Do we think they went deep enough? Did they do enough sample testing? Is their materiality an acceptable one for us? So, you know, we have a number of questions in our head before we start the process.
– ACC, Other listed equity*

How do we assess the quality? [We use] feedback from the finance director and the finance team of how the audit is progressing from their point of view. There is feedback from the head of internal audit of how he feels the audit is going because there's liaison between the internal audit and the external auditor, and the quality of the report. – ACC, Building society

We have discussions on the softer side as well around the extent of challenge and pushback that we feel the auditors are exercising as they go through their audit.

– ACC, FTSE 100

They are also looking at the quality of the auditors' interaction with management as a gauge of audit quality.

I look at the quality of their interaction with the management, so the management feedback, and say, 'Yes, have they done a good job? Have they taken the time to go and familiarise themselves with the business? Have they met a lot of the staff and the management? How much time have they invested in getting to know the business?'

– ACC, FTSE 250

You'll get feedback from management as to how effective that interface between management and auditor has been, in terms of finding and resolving issues.

– ACC, FTSE 250

It may be a bit flippant to say, but sometimes based on how much my CFO is moaning, because that means that they are really questioning him on his decisions, on his presentations, and if everything gets too smoothed and everybody seems to be incredibly happy, then I'm starting to question whether this audit is going right. Because in the end, the thing is that if the auditor is instantly happy with the answers the CFO gives, then that makes me nervous because they have a role to, you know, assess the quality of our finance department. – ACC, FTSE 100

In addition to the various forms of personal communication and interaction, ACCs also look to hard evidence – typically in the form of reports from the auditor – as a guide to audit quality.

You're looking at the actual quality of the reports which come back, which typically is a summary report, and a much fuller report of the full year, which also includes something called a management letter, where they comment on control points. And so you're looking at the quality of the reports to you, and saying, 'Well, how comprehensive do they feel?'

– ACC, FTSE 250

There's usually an interim report, which tells you about their progress and how they're getting on and any issues which they've highlighted and then give you a chance to, again, interact with the external auditors. And thirdly, their final report, where they give a report of the final audit work that they've done. And through that, you get an impression of quality.

– ACC, FTSE 250

On the objective side, you can see clearly the quality of the reports and information that come from [the auditors], and the extent to which things are thought through, in terms of the inputs they give to the material. – ACC, Insurers

You can't write a good quality report to the Audit Committee if you haven't done the good underlying work and have properly, you know, got on top of the issues and then thought hard about what to raise and how to raise it. – ACC, FTSE 100

Surveys represent another form of hard evidence that ACCs use to gauge audit quality. Typically, these surveys are carried out among the firm's senior leadership, Audit Committee, and the accounts function within the business. Surveys were not mentioned by all ACCs, but for those who do use them there is clear anecdotal evidence to suggest they are a useful tool in the ACC's arsenal to assess audit quality.

The other thing we have at [this company], and I think most firms do, we do actually have a formal questionnaire. We introduced it last year, to get the Audit Committee to answer some specific questions ... to say whether we're satisfied with the audit every year, as part of the code. And we do have a questionnaire which we've used now to get the Audit Committee members and the management, the executive managers, to fill in as well about how the auditors have carried out their work; were we satisfied with the way they raise issues. – ACC, FTSE 250

We will also conduct our own process, both the company internally and the Audit Committee, to assess the quality of the audit, both from management's point of view and from the Audit Committee's point of view. And that involves filling in – the various teams within [the company] are asked to complete a questionnaire answering questions on different aspects of the quality of the audit. Those are then collated all together for the management point of view. – ACC, FTSE 100

We do a survey again down through the divisional finance directors. And that's useful, and sometimes it can point to parts of audit teams that aren't as strong as they might be, which you wouldn't know from the top ... [W]hat we're trying to get at are the points that I mentioned before. I mean, did the auditor focus on the key issues? Did he understand the key issues? Was he both robust and flexible? – ACC, FTSE 250

Challenging auditors and resolving conflict

During the process, ACCs are expected to build rapport with the auditors but also challenge judgements and findings, without creating excessive conflict. It is important that the relationship is not too comfortable and that both auditors and ACCs are sceptical when needed and ask the hard questions. As well as challenging judgements, they oversee the entire audit process to ensure it is effective and robust.

They have to be sceptical; they have to challenge; they have to ask questions. And in my view as an Audit Committee chair, if the relationship with the auditors and the management is too comfortable then it's not going to work. There has to be a bit of friction. And more importantly, the word that is often used is 'independence'. – ACC, FTSE 250

I'm always challenging, I'm always asking the questions. I think that is your role as audit chair and anybody on the Audit Committee ... So, yes, challenge with a small 'c'. Continually challenge, continually ask those questions, make sure people think that you really are watching them, because we are, and we should be. – ACC, FTSE 100

Getting that balance is hard ... [Y]ou want to build a working relationship but never crossing the line in terms of that balance of challenge and independence and questioning. – ACC, FTSE 100

I think 'challenge their judgement' might be the wrong description, but, as a result of the audit, they will come out with a report that says, 'Here are some areas, maybe errors, that need to be adjusted', or, 'Here are some areas where, in our judgement, you're not technically complying with the spirit, or the actual way this accounting standard has been written.' ... So, the challenge would be to really understand, 'Why are you saying that?' And, 'How did you come up with that answer?'. – ACC, Building society-listed debt

A small number of ACCs preferred to refer to 'challenge' as a healthy friction, a negotiation, or a debate; they found the word 'challenge' to be inaccurate or confrontational instead of positive, valuable and crucial to obtaining a quality audit.

Usually, with decent firms, you're talking about opinion and, 'Wouldn't it be better to do it this way?', particularly, when you're talking about disclosures. You will debate those and, you know, you can challenge them. In the end, they've got their job to do, which is to provide an independent opinion and they will do that in their audit report, and they've got a right to stick anything they like in the audit report. So, they've got a nuclear option if we challenge, they don't agree and we don't change the accounts, then they can report it in their audit report. So, there tends to be something of a negotiation, where you then come to what's, hopefully, a sensible outcome. – ACC, FTSE 250

'Challenge' most frequently occurred during the planning stage when discussing the audit scope, as well as during the first half of the audit, with the aim of there being less of a need, if at all, to challenge in the second half of the audit, in order to ensure a timely audit reporting process. Some ACCs spoke of drawing on their own expertise, including sector experience and business knowledge, as well as any previous experience of audits, to challenge the audit team, especially if they were a new team or firm. This experience helped ACCs measure the effectiveness and robustness of the audit.

We debate the key accounting judgements at some length, and then we check the reasoning. Do we think what [the auditors] might have told us was reasonable? Do we think they went deep enough? Did they do enough sample testing? Is their materiality an acceptable one for us? – ACC, Other listed equity

In the planning stage, I would want to see the plan to make sure that the plan covers everything I can envisage. Then what I like to do is I like to go with the auditors to the site visit because then I can see how diligent they are in looking at the site. I can hear them asking questions. – ACC, FTSE 100

ACCs reported challenging auditors with management present but also when they were not. By meeting without management present, some ACCs reported that audit teams felt more comfortable to raise concerns and confusions. Many ACCs spoke of wanting to prevent, predict and resolve issues before Audit Committee Meetings.

*I normally try and have the conversation first with the audit partner outside of the Audit Committee and try and unpick it and give him a chance to explain where he or she is coming from, and then challenge it within the Audit Committee and seek the views of others within the Audit Committee, and then indeed within the main board.
– ACC, Building society*

*I would then have a debrief call or a meeting at the end of the site visit once they've had their first results and we would discuss the high-risk areas, the areas where we're going to anticipate dispute with the management because the management sees it differently.
– ACC, FTSE 100*

We would have a chat, before every Audit Committee, to find out whether there are any issues that worry him, or whether there are things where he's not getting the cooperation that he should, or the firm isn't getting the cooperation that they should. – ACC, FTSE 250

The complicated conflicts are where it's a judgement, and then my role is mainly to be that of a mediator so that both come away with a result which they can live with. So, when it gets emotional, you try to take the emotion out. You try to go back to basics, but it's basically what you do as mediator and if everything fails, then we'll put it in front of the Audit Committee and discuss it in the Audit Committee and see whether we can find a solution, but most of the time it's solvable. – ACC, FTSE 100

Many ACCs said they do have a role to play when there are disputes and conflict between company management and the auditors, but hoped it would be solved without them needing to step in, in advance of the reporting stage to avoid delays in sign off.

There are certainly instances where we as a committee have taken a view that's different from the one that the auditor took. In doing that, we firstly have evaluated the consequences of that, because it generally impacts on adjusted differences. Made sure that we were comfortable we understood why we were doing it and made sure the minutes reflected the debate and the auditor's view, because the auditor should be protected in that case. – ACC, FTSE 250

I had a couple of meetings over the year end with both the audit partner and with management on a particular issue ... [N]ormally I would have expected the CFO and the audit department to resolve most of that and come to a conclusion, but because it was quite contentious and because it was a reversal of an existing opinion that we'd been given, it became quite a challenging environment, so I needed to get involved. Obviously, the quality of the external audit is my responsibility, so I need to make sure we're making the right accounting decisions. – ACC, FTSE 250

If my CFO cannot reach agreement with the auditor, my first act would probably be to fire the CFO and then the second would probably be to change the audit partner for not being able to persuade the management that that's the correct treatment ... I think you have to respect the auditor, that their business is putting that signature on a bit of paper.

– ACC, FTSE 100

Frequency and methods of communication with the auditor

ACCs utilised both formal and informal feedback channels when engaging with their auditors. Audit Committee meetings and the pre-planning meeting were the key means of formal feedback and were held via video conference software during the pandemic. Additionally, many ACCs scheduled regular (c.4–8 weeks) informal phone and video calls to check on the progress and to get an early read on any concerns, with the frequency of both formal and informal meetings increasing as the audit evolved. Overall, ACCs expected communication to be ongoing across the audit cycle, with timely and clear communication of issues seen as a key indicator of audit quality.

I think we have six regular Audit Committees, so I would have six regular meetings around that, but I'd probably talk to the audit partner certainly every month, and then during the half years, particularly at the year end, more frequently than that. – ACC, FTSE 250

I'd normally meet an audit partner every couple of months, face to face, for coffee, which will be a general catch-up; it might just coincide with a delivery of something, but sometimes it will just be meeting up. – ACC, FTSE 100

We have five Audit Committee meetings a year. They always used to be physical, so we would have not just the time on the phone, we would also have time to meet, and socialise, and get to know each other better. – ACC, Other listed equity

During the course of an audit, I could quite expect that the audit partner might get in touch and say, 'Can we have a chat, just two or three things.' So, there's a reasonable amount of contact, dialogue, and it's a mixture of formal and informal between set [times] and ad hoc. – ACC, FTSE 100

Nearly all of the ACCs stated that regular and open communication with the audit firm was critical; issues need to be raised in a timely manner as delays could have a significant impact in terms of signing off company accounts. Surprises late in the day were viewed to show a lack of a quality audit or service.

Identifying issues and raising them early enough, I think, it's critical because whilst you want them to challenge something, you don't want them to only mention it to you only four days before the results are due to be announced because it could give you a problem. – ACC, FTSE 100

The Audit Committee and the Audit Committee chairman are not day-to-day in touch with the audit as it progresses. You're only in touch with the auditor if there are significant findings that are being discussed with you on a timely basis, and you would hope there aren't any. – ACC, FTSE 250

The auditors will never be able to do their job unless they ... are discussing any findings or matters arising on a timely basis ... If they're of sufficient importance [there should be] an open channel through to the chair of the Audit Committee, and the whole Audit Committee if necessary, to ensure that things are properly understood and resolved on a timely basis to help the company achieve its corporate timetable, and where performance issues are openly discussed and debated, so the audit can continue to proceed as smoothly as possible. – ACC, FTSE 250

I expect to be told relatively promptly if there's an issue which has been highlighted during the audit ... The routine is there's usually a planning presentation, which gives you the opportunity to highlight areas that they're focusing on, what we think should be focused on. – ACC, FTSE 250

Most ACCs believed that face-to-face meetings, especially when management and auditors are present and when planning an audit or discussing issues, was the preferred method of communication. However, in 2020–21, contact had predominately been via email and video or telephone conferences due to the Covid-19 pandemic. Despite many having initial worries about the lack of face-to-face contact, most had been pleasantly surprised by how effective and regular the online communication had been. The majority did not think it had caused any negative impacts. However, a few ACCs said communication had been less ad hoc and informal, as they had not ‘passed by auditors’ in the workplace to say hello, observe and quickly answer questions.

[Pre-Covid] you just listen and observe and that’s where you soak up a little bit of the cultural things, you know, the nuance of the debate. If you’re sitting in someone’s office and hearing some of the conversations or the way people talk to each other ... So, I think we’ve probably lost a little bit of that. – ACC, Other listed equity

The quality of debate has been impaired significantly. Boards are getting through agendas and having discussions but they’re not having engaged debate, which is incredibly difficult over Zoom. – ACC, FTSE 100

We have found a way to work and they’ve set up all these secure portals to pass information across and there’ve been Zoom calls or Teams. In a way they’re more structured because you can’t just, you know, slope up to someone’s desk to ask questions during the day. You’ve actually got to put it in a diary ... that brings a lot more discipline for both parties, which has been helpful and unexpected because I would have thought it would be quite difficult to do an audit remotely. But, actually, some of it has worked better. – ACC, Insurers

Reporting on quality

There was a sense that Audit Committees’ work on quality is difficult to articulate in a report as it is often intangible and subjective. A few ACCs described their approach to reporting on quality as ‘boilerplate’, limited and brief. There was little evidence of committee reports including a dedicated section on quality; it is instead referenced, often implicitly, in the section on the committee’s activities and any issues they dealt with. A small number would review data from their internal survey, which included questions on the performance of the auditors, such as timing of their communication, quality of audit and their challenge of management. A couple spoke of wanting to be neutral in their write-ups to avoid ‘public shaming’ of the auditors, especially if it was linked to a poor-quality service rather than a poor-quality audit; however, they would give feedback verbally to the audit firm.

I'm not sure my annual report to shareholders has a section where I report specifically on quality of the external audit. I report on what the committee's activities have been and the issues the committee has dealt with, so I'm not sure I actually sit and report on our assessment of quality. Quality would be only one of a number of different attributes that you would consider when you do your annual review of [the] auditor. – ACC, FTSE 250

*I don't think we actually display how we evaluate. I think we have evaluated quality but didn't actually report on it. You've got me thinking now. I think it's a difficult thing.
– ACC, FTSE 250*

[Reporting on quality] – I don't think it's my primary focus. It's more holistic than just pulling out quality. I guess if we had any doubts about the quality then maybe it would come to the fore, but it's almost a given, because the procedures that we go through ensure that we have quality on it ... I think we really refer to effectiveness more than quality. – ACC, FTSE 250

A few reflected that they would like more guidance on how to measure and report on quality.

In terms of the external reporting of what we've been doing, I think it's probably quite limited. I think that's one that everybody struggles with. We tend to put in some, sort of, somewhat boilerplate words around what we're doing. When we talk about surveys and questionnaires – I think we struggle with it, because I think we struggle to articulate it, because it's quite hard to describe ... I don't feel there's a lot of useful guidance for Audit Committee chairs on how to assess quality. I think it's an idea of what 'good' looks like, but then it's not about reporting, it's about what you do. – ACC, Building society

*I think it would be useful if there was some sort of written [guidance], perhaps on how we should be measuring audit quality; that might be useful, but I haven't seen one.
– ACC, Insurers*

The quality of audit reports

Like as in 2020, some Chairs think audit reports have become too long and that the Committee's report can feel like a duplication of the auditor's opinion; both of which put people off from reading and learning from them. As audit reports have become more standardised, a few commented that they have also become generic and tick box, which can lead to a loss of meaningful data.

I feel the biggest challenge of the auditor's opinion and the Audit Committee report, is they basically duplicate each other ... You have to say what the Audit Committee covered, and the same stuff is then in the auditor's report. – ACC, FTSE 250

I worry a little bit that it's become too boilerplate and there's too much in it now, and you can't see the wood from the trees. I think they're becoming too long ... The reality is a few small shareholders will read them before, but the vast majority of people making decisions about buying companies do not read the annual report. They will not read the whole annual report, they'll read sections of it, and the Audit Committee section, I think probably will be the least likely one to read. They would read parts of the audit report where they think there are areas of contention. – ACC, FTSE 250

I think everything's getting longer but is it getting more meaningful? I do worry that nobody will read it because they'll just look at it and go blah blah blah blah ... Our directors are saying this to our executives all the time, 'Tell me what's really happening, tell me, you know, the high-level executive summary' ... And unfortunately, I think there's very little of this in audit reports and other reports, and there's tons in the middle which is just, 'Okay, did I learn anything from that? Not really.' – ACC, FTSE 100

Well, nobody ever reads the Audit Committee report. Investors have zero interest in the Audit Committee. We've offered countless meetings and they've said, 'We've got no interest and we don't have the resource to be able to engage with Audit Committees' ... We talk about audit quality and how we get comfortable but it's frustrating because nobody's got any interest in it. – ACC, FTSE 100

ACCs proposed that a high-quality audit report would be:

- on time;
- compliant with the FRC's guidance;
- succinct;
- avoid too much detail on immaterial items and disclosure points;
- focus on the areas of risk that will impact the future of the business the most;
- ensure the key learnings and messages stand out;
- include sector benchmark performance data where possible.

Our current auditors do a lot for us in terms of benchmarking and that's very valuable to us. They do provide quite a lot of informal benchmarking in terms of comparing things that we're doing with what they're seeing elsewhere ... and that's useful as well, and probably more importantly, rounding out or giving us pointers as to what others are doing differently that we might do differently. So, we can either think about whether we should adopt it, or why we're not. – ACC, FTSE 100

*It's about the issues and the points which they raise, and whether they are really focusing on the big major areas, and whether they have done sufficient work to assure themselves on those areas, have communicated well to me and the committee that they're across those areas, and having a good dialogue. That's what I think is a quality audit.
– ACC, FTSE 100*

Changes in the audit sector

Impact of Covid-19

In 2020, ACCs had been extremely concerned about how the pandemic would impact the effectiveness of the audit as well as the ability to meet deadlines, but in 2021 ACCs tended to be pleasantly surprised by the outcome.

The pandemic has accelerated technological advancements when it comes to the audit process, making it more efficient, and timely, particularly with the use of data analytics. New processes were set up promptly and have been effective and will continue to be used in the future.

Clearly [the pandemic] was very daunting but in reality, it's gone extremely well ... Communication is more challenging when people are not at their desks and you don't know whether they're working or not working and things, but we got through it. We probably ended up a few days behind where we would have ideally wanted to be ... We've put in a lot of effort to make sure that where we've had to change our processes that internal controls are being maintained, and testing those controls. – ACC, Building society

There have been a lot of positives actually, forced remote working and remote working on Zoom or Teams has actually required much more discipline around about daily contact. Interestingly, to some extent, the necessary cooperation and teamwork between client and auditor has probably improved because with the difficulties of remote working people have had to find their way round about it. So, that's been a positive. I think there has been some really interesting innovation. – ACC, FTSE 250

My view was that [the audit] actually went really well, considering that I think generally remote auditing actually worked to a better degree than any of us thought. So technology has definitely worked for the benefit of the audit process. – ACC, FTSE 250

I think it's made the audit team do things remotely, so we're not physically in the premises, and I think that's a challenging area, but I think with the use of technology, as long as the audit is planned properly as a project and managed properly as a project, it can be as seamless as it would have been previously. It's made life slightly more difficult: you can't just be in a room and walk round the corner to meet the finance team, and you have to arrange appropriate contact points. – ACC, Building society

However, the pandemic has made informal interactions impossible, which are valued highly by ACCs. Face-to-face interactions and ad hoc conversations as soon as an issue arises are important to building strong and open relationships. This rapport also increases transparency between the auditor and the ACC. Some also commented that proposed timelines have been delayed, but not dramatically.

It obviously means that one of the ways in which auditors carry out their job, you know, the informal side of it, is that they go and meet people on site, they walk around offices, and they get a little bit more close to the business and a sense of what's actually going on, right? Now, in a remote audit, they can do all the technical stuff very well, but, increasingly, they can't do the informal. – ACC, FTSE 250

It has enhanced my understanding of each of the businesses I'm associated with, because we started having weekly catch-ups about the business, about the issues, about the employees, obviously the process that each business was following and how they were impacted by the pandemic. But just the fact that we had a touch-point more frequently. But I don't feel like the quality can have suffered much. Because they now document so much electronically. So we can just send them the different files they need. I know it's not as good as seeing the whites of the eyes and, you know, seeing body language when you ask someone a question. – ACC, FTSE 250

The pandemic disproportionately impacted certain businesses and individuals; industries which were more impacted by lockdowns, e.g. hospitality, were more likely to be managing different internal issues alongside running their audit. Impact on businesses also depended on the date of their year end falling just before or during the pandemic.

ACCs were concerned that younger auditors were disproportionately impacted by the pandemic; there was added pressure and strain when working from home, leading to mental health issues. This concerned some ACCs, as it makes audit a less attractive profession to remain in.

It went surprisingly better than I'd feared but, that said, it prolonged the process, simply because neither our staff nor the audit staff were on-site. We all had to learn new ways of working and providing audit evidence, putting in place systems, protocols to share confidential data, etc. It invariably meant there were some delays. But I think, both in terms of our own people and the auditors ... it has meant that people have had to work differently ... So, I think I'm more worried about the mental health of people who are working. – ACC, FTSE 250

Audits tend to be conducted by relatively junior people in the firm with the least experience, and in a normal year they're working in teams, they can learn from other people. This year, they've been working on their own from home, and I'm sure that's been difficult and more stressful for everybody. But the other side of it is I think audit firms have been losing people at the newly qualified level. So, that's the life of somebody on an audit team, in the last twelve months, I think that has been really difficult. The attractions, the appeal of the profession probably doesn't look very appealing because you have got the FRC saying, 'We want you to do more, and more, and more.' – ACC, FTSE 250

Did it ultimately impact on the audit? Well, yes, but it impacted on us because we had a large acquisition during the year, which had to be done with at the year end, and that was the first time. There was a new audit, all that was going on. Did our timetable change? Ultimately, no. Did the quality of the work change? Ultimately, it was different, but no, I don't think it did, but I would say there was a lot of planning and a lot of working around to make it happen. – ACC, FTSE 100

A 'proportionate' monitoring regime

ACCs discussed their views on regulator powers and what a proportionate monitoring regime should look like. The majority felt that increased regulation adds pressure for auditors, leading them to focus more on process than judgement.

The more and more bureaucracy we get in this country, the more anti-competition we have and it's just that we're getting that we can't actually do anything nowadays without somebody having to look over our shoulder. – ACC, FTSE 100

I wish they would stop trying to enhance, because it's a moving target. I do think what we've got in place is adequate. It is just how you exercise the judgement, as the Audit Committee. It almost feels like they don't trust us to do that. – ACC, FTSE 250

From an ACC perspective, the increase in rules and regulations have made audits more complex, expensive, and more about ticking boxes without necessarily picking out the 'bad apples'. Furthermore, auditors can become consumed with the technical aspects of the audit without seeing the 'bigger picture'.

ACCs highlighted that current systems do not allow space for innovation and that regulations can be too restrictive; if procedures and standards are too prescriptive this can prove limiting. Overall, the audit process is felt to need a degree of subjectivity, flexibility and judgement.

I have experience of individual firms that have come under regulatory pressure, where their behaviour has changed very significantly, and from a client perspective, not for the better. I think it's a very difficult area. Being a regulator is not always easy and it's hard to regulate something unless you can see the evidence that something has been done. So, inevitably, the regulator looks for more and more evidence of how things have been done, not only what's been done, but how decisions were made. That forces the firms into documenting things more, but the more you document, the more, to some extent, you open yourself up for challenge. So, the more documentation is done, the more carefully it needs to be reviewed. So, you find yourself in a route that means there's more to do, more hours to expend, if you like, to keep the regulator happy. – ACC, Other listed equity

So I think there's far too much rule-based accounting, rather than principles-based accounting, and I worry that if we set up a set of principles of 'What is a good audit', they soon become rules of a good audit. And just going back to the point about the audit, I think audit quality has improved over the years, I think it's much better than it was ... They are doing far more auditing by checklist now, and they are doing tick, tick, tick, tick. I completely throw that out because you want to apply knowledge and judgement ... Not just tick through a set of things that we have to tick off. And you spend all of your time filling in checklists, without actually standing back and assessing what you've heard.

– ACC, FTSE 250

Though the majority feel that current measures are proportionate, there is still an appetite for more controls around making sure measures are being followed in the correct way.

I think that there are things that auditors could do more of, in terms of, the spot checking they do, the materiality they choose ... I think there are more activities that they're beginning to do already that need to be nailed in, and concreted in, and made sure that everybody does going forward. Personally, I think there the onus is on companies like the ones I represent, to spend more money on their own internal auditor and finance control systems ... We need to be better. I think the regulators need to look more at the role of the boards and what are they prepared to invest in. – ACC, FTSE 100

You know, you can look at the audit plan that they present and say, 'Oh, we're concerned about this area', or 'That doesn't look like you've got enough coverage of what's going on here', and so on. But it's very hard to know. As an Audit Committee, it's very hard to know whether they've done the detailed level testing, you know, in the right way, other than by things not going wrong. Or things not being identified, you know. – ACC, FTSE 250

Clearer guidance and proposed metrics ... could be used. And as we talked about, AQR measures that meaningfully communicate the [audit] quality – ACC, Building society

The role of the FRC

There was a mixed response around what role the FRC should play amongst the ACCs we spoke with. Some mentioned their frustration about the increase in rules and regulations around audit and how this hampers progress and innovation. Though challenge is critical, ACCs often stated a need for the FRC to cooperate and collaborate with firms, working together to identify issues in a preventative rather than reactive way.

I think they [FRC] should be challenging us ... It's a difficult area; I think it's going to be difficult for the FRC to develop or improve on what is there already. – ACC, FTSE 250

I think the fact is that FRC are demanding better communication between the auditor and a higher quality of audit. So, I think the FRC, by being there and doing these checks is leading to a higher quality audit in any case. – ACC, Building society

What [FRC] need to do is step back, listen to people, and actually understand how they're going to work. Because without the companies and the auditors working with the FRC or the ARGA, they won't succeed. They might think they will with lots of powers and everything else, but they won't because at the end of the day, they won't be able to execute the powers because nobody will cooperate with them, and it's based on cooperation. – ACC, FTSE 100

The media focus on recent failures in audit such as Patisserie Valerie, BHS and Carillion, adds more pressure to audit firms and to the FRC as a regulator. However, some ACCs feel that their audit firms are punished for the failings of poorer quality firms, when they are making constant improvements to the audit process.

I get quite irritated by what I see as politics being played by the FRC ... FRC's line that says 30% of audits need improvement, and they include minor comments on reaching that 30%, and so government sees a headline from the FRC, that says 30% of all audits are terrible, and I think it's just misleading politics from the regulator. I think that my experience is the firms have invested significantly in the importance of audit quality, and continue to do so. – ACC, FTSE 250

ACCs often felt the FRC offers short-term fixes to long-term problems; focusing on immediate, solvable problems rather than investing in root cause analysis of failed audits.

The proposals being made now are trying to improve the quality and fix a short-term problem, which does need to be fixed ... But there is going to be a longer-term problem down the road and that's the risk for the profession in the UK ... The FRC needs more teeth ... but it needs more teeth in a way that doesn't do damage; so some of the proposals that are out there now, to me, are more damaging. – ACC, FTSE 250

ACCs commented that the FRC are too focused on documentation, rather than action; by fixating on documentation and tick boxing, some feel that the FRC can miss out on major issues within some firms. This leaves some feeling that ‘a few bad apples ruin things’ for others who have plenty of audit quality checks.

Finally, though ACCs welcome the FRC’s reports, some feel that these come too late, as issues arose two years previously and have often been resolved by the time the FRC report on them.

I suppose one area of external benchmarking is this FRC annual review of audit quality. And the problem with that is that by the time it’s actually published it’s gone out of date because it’s done on audits, you know, from the previous year. So I guess that might be one issue. – ACC, Insurers

And there’s now too much tick box because the audit firms are scared of getting a bad review from the FRC rather than ... they spend their time on that rather than looking at the really important judgements. I think they’re taking away the ability of an Audit Committee to do the right thing because we’re going to spend all of our time focused on ticking the FRC boxes and not on doing what the Audit Committee should be doing, which is thinking about the business and management’s judgements. – ACC, FTSE 250

Familiarity with Audit Quality Indicators (AQIs)

As in the 2020 research, the majority of ACCs had an awareness of AQIs; however, ACCs did not mention using these regularly, compared to other criteria and reports, e.g. transparency reports. However, AQIs are used by smaller businesses who wish to benchmark and compare themselves to other businesses.

Overall, AQIs were felt to be lacking in specificity and, when probed, indicators like comparatives, greater explanatory narrative, and benchmarks would be welcomed.

I think [AQIs are] too general and I don't find them particularly helpful ... I think it's individual judgement rather than having a checklist. – ACC, FTSE 100

I'm familiar with them conceptually, I don't spend a lot of time reading them, I find them quite difficult ... I suppose, well, I read it and I go, 'So what? Does that mean I'm getting a good audit or not?' I don't feel there's a lot of useful guidance for Audit Committee chairs on how to assess quality, written for us. There's FRC stuff, 'Here's a pile of AQIs you might like to use', but it's a bit of a shopping list ... I want to know how my audit compares to the firm or how it compares to other firms; so I think the last two, benchmarks and indicators across other firms, are useful.

– ACC, FTSE 100

Though most ACCs won't make major decisions based on AQIs, some find them useful to refer to. ACCs found AQIs particularly useful in the tender process, as it allowed them to compare and contrast different firms. Though firms' transparency reports were felt to be more effective in getting an understanding of an organisation's culture.

I know the FRC thinks they use it as a marketing document. But it's a useful indicator, and actually, it's quite interesting to compare it to what listed companies say in their annual report accounts about things like risk management, around people, around ESG matters, to see that side of it. And the two are not that different and they have some statistics in them. They're more qualitative than they are quantitative, but they are part of it. And also, it gives you a pointer to what's important to the firm, I think. So, they're helpful.

– ACC, FTSE 100

As seen in 2020, ACCs continue to have an appetite for historical comparison and latest trends, increasing the utility of the AQIs to an extent. In addition to this, they would like to see AQIs related to their sector.

[AQIs are] a useful framework and, again, helpful, depending how you go about your review of auditor effectiveness; if you're doing a little questionnaire first it's helpful in the construction of the questionnaire. I think you have to be careful not to get into a checkbox mentality with things like that. – ACC, FTSE 250

[AQIs are] definitely something you look at when you're considering the tender process. But it is almost like a given that you're expected. But whenever you see, like, the league chart, you want to make sure that your audit firm is the best one. I guess, we've grown accustomed to it, and maybe we're taking it for granted, and maybe the way it's recorded could be refreshed. We would miss it if it were gone, yes, definitely. – ACC, FTSE 250

I do take time out to actually read them [AQIs], because I think there's an opportunity for me to learn; not necessarily about individual companies or firms, because I'm not going to change an audit based on that from one year, but are there any underlying issues that I think, 'Actually that's a good one, I need to think about that.' – ACC, Other listed equity

I think, rely on our own judgements about how the audit firm sits in relation to quality, to a very large extent. I think that might be altered if there was a particularly high-profile and damning indictment of somebody's audit quality ... [W]e rather assume that they are going to produce a good quality audit. And, if we're not, then, it's a bit of information that perhaps we're not using as well as we should. It's an interesting point as to whether perhaps the Audit Committee might be required to consider a statement of the indicators of how the firm sit as part of the annual review, which currently we really don't. – ACC, FTSE 250

Technical appendix

Sampling and recruitment

In collaboration with the FRC, following desk-based research, YouGov compiled a database of ACCs to contact. ACCs were contacted in two waves, allowing us to ensure a broad mix of respondents in terms of business sectors and company size, including FTSE 100, FTSE 250, and smaller listed entities. In the first wave of invites, YouGov contacted participants via email and in the second wave ACCs were approached via LinkedIn.

We also sought out those entities that had recently conducted an audit tender, as well as those with experience of being audited by non-Big Four firms. Within the sample, some had trained as accountants and/or had worked at one of the Big Four firms at some point in their careers. The table on the next page sets out more details of the interview sample. A number of the ACCs interviewed were the chair of more than one Audit Committee.

In wave 1, YouGov reached out to ACCs using a co-branded email, sending a warm-up email introducing the research, followed by a formal invitation to participate, and finally two reminder emails.

In wave 2, where email addresses were not publicly available, desk research allowed us to identify ACCs on LinkedIn. ACCs were sent details on the project aims and invited to participate. They then supplied their email addresses to set up their respective interviews.

In line with MRS guidelines, all participants were given the option to direct a donation to a charity of their choice in recognition of their time.

Verbatim quotations have been used throughout this report to illustrate key themes and findings; however, these are not attributed to individual participants.

Discussion guide design

A discussion guide was developed in partnership with the FRC, covering the audit process from tender, to planning, execution, and evaluation. The discussion guide also touched on changes to the sector in 2021. Discussions were semi-structured and focused on the experiences and views of ACCs.

Following sign-off of the discussion guide, 15 pilot interviews were carried out in order to test the language and flow of the guide. YouGov then produced an interim report, which outlined emerging findings. Expert advisors reviewed the report and also shared their views. After presenting this report, a small number of questions, as well as clarifying points, were added to the guide for the remaining interviews. Please see Appendix 2 for the full discussion guide.

Analysis and reporting

Interviews were transcribed and compiled into an analysis grid. Initial analysis was then undertaken by the research team for this project, including regular meetings with moderators to share emerging findings. A more granular secondary analysis was subsequently carried out by YouGov’s researchers after wave 2. The findings from both waves of the research are outlined in the following report.

Note on the nature of qualitative research

It is important to note that the discussions with ACCs were qualitative in nature. The aim of the research was to explore, in detail, ACCs’ views on, and approach to, audit quality, identifying the common themes as well as the specific nuances.

While the number of interviews completed is large in the context of qualitative research, and a saturation point of common views was reached, the findings cannot be taken as statistically significant (i.e. the findings cannot be extrapolated to all ACCs). However, the research provides a rich understanding of a diverse sample of ACCs’ views on audit quality, which can help inform the future work of the FRC.

Summary profile of ACCs interviewed.

Interviews Completed – 50 in total	
<u>By sector</u>	<ul style="list-style-type: none"> x2 Automobiles and Parts x10 Banks x1 Basic Resources x3 Chemicals x4 Construction and Materials x7 Consumer Products and Services x3 Energy x17 Financial Services x1 Food, Beverage and Tobacco x3 Health Care x7 Industrial Goods and Services x6 Insurance x3 Real Estate x2 Tech and Telecoms x4 Travel and Leisure
<u>By Market</u>	<ul style="list-style-type: none"> 16 FTSE 100 29 FTSE 250 19 Other listed 9 Unlisted entities

N.B. The numbers above sum to more than 50 because some interviewees were ACCs for more than one company.

Discussion Guide

Introduction (10 mins)

Moderator introduces themselves and YouGov, and the wider aims of the project that are to provide the FRC with a rich understanding of ACCs' views on, and approach to, audit quality.

The conversation today is an informal discussion of quality, please be as open and honest as you can – your contributions will be made anonymous.

On conclusion of the research, we will produce a report for the FRC outlining key themes and findings; however, your comments will not at any stage be attributed to you or your organisation. We will be talking to 50 ACCs of Public Interest Entities (PIEs) during this project, and you will not be personally identifiable in any outputs we produce. It is intended that the report will be published by the FRC at a later stage.

The interview will be recorded for the purpose of note-taking only. The recording will not be shared with the FRC. The recording will be stored securely. YouGov operates within the relevant Market Research Society guidelines on best practice, including GDPR.

- Do you have any questions before we start?

- To start with please could you tell us a bit about yourself:
 - Which company boards do you sit on as an ACC? How long have you been in the role? *If more than one as ACC – As we go through, we'd be interested in any areas where the approach differs depending on the board sat on.*
 - How did this role come about? How were you appointed? (**Probe:** recommended?) By who? (*Note: interested in anything about personal contacts.*)
 - What is your time commitment as ACC? (N.B. throughout the year.)
 - And what does your role involve as an ACC? How would you define it?
 - Have you ever worked for an audit firm? If so, did you work for any of the Big Four (Deloitte, PwC, KPMG, EY) and/or for any others?

Let's start off with a broad question before we go into more detail ...

- Overall, how would you define a good quality audit? What does it involve?
 - (*Moderator pull out a few and probe – most interested in scepticism and challenge.*) You mentioned X. What does this look like? How do you assess this?
 - Is there adequate guidance currently on what constitutes a good quality audit? If no, what is lacking?

Selecting an auditor (10–15 mins)

- Have you undertaken a tender for an audit within the last five years, or are you about to?
 - How far in advance do you plan the tender and why?
 - Can you talk me through the tender process as it relates to ensuring a quality audit?
 - *If more than one board sat on:* does the approach differ at all? If so, how?
- How many audit firms are typically invited? How do you decide on these?
 - Do you have experience of appointing a non-Big Four audit firm? If so, what was your experience of this? If not, what made you go with a Big Four firm?
- What factors are important to you in selecting an auditor?
 - What do you look for in the lead audit partner? Does this differ for the rest of the audit team? Why is this?
 - Can you give an example of what this would look like; how this is assessed?
 - Do the results of external and internal quality inspections (audit quality record) inform your selection? **Prompt:** *FRC's Audit Quality Review (AQR) findings.*
 - Why is this?
- To what extent do you consider the firm's own governance arrangements? **Prompt:** *FRC's Audit Firm Governance Code/firm's Transparency Reports.*

Planning and executing an audit (25–30 mins)

- How do you, and the Audit Committee, assess quality during the audit?
 - What evidence, if any, do you use to assess quality? (*Note: pull out hard evidence, such as documentation, versus soft evidence, such as the manner of the audit partner.*)
 - Do you feel confident in the measures and methods available to assess quality? Are there any areas where it is harder to gauge?
- How, if at all, do you challenge the auditor's judgements? At the planning stage and the performance and evaluation stage?
 - Could you talk me through an example of where you have done so – what prompted you to make this challenge, and what was the outcome?
 - How, if at all, do you challenge auditor's findings? Could you give an example of this?
 - What about challenging company management?
 - Do you have an example of questions you might ask company management? (*Moderator to probe on which questions take longer or are more complex to solve.*)

- Do you consider audit firm culture in your assessment of quality? (With management and each other.)
 - If not, why is this? If so, what information or action is involved in this assessment?
 - How, if at all, are you able to assess culture during an audit? What does good audit culture look like?
 - What impact might audit firm culture have on audit quality, if any?
- Have there been instances where you have had to resolve conflict/disagreement between the auditor and management?
 - What, if anything, is the role of the AC and ACC in these instances?
- How frequently do you engage with the auditor during the audit, and what form does this take?
 - Do you meet without company management present? If so, how often and under what circumstances?
 - How would you describe your relationship with the auditor(s)?
- What is your approach to reporting the Audit Committee's work on quality in relation to the audit? (**Probe:** how does it demonstrate focus on quality?)
 - Does the Audit Committee's report distinguish between audit quality (*effectiveness of the audit at addressing matters that could comprise the quality of company reporting*) and the quality of service (*which relates more to relationships*)?
 - Are there any challenges to reporting the Audit Committee's work on quality? If so, what are they and what might help?
- Has the pandemic had an impact on your company's financial reporting and audit process? If so, how?
 - Do the impacts you mention pose a risk to audit quality? If so, how have they been mitigated?
 - One example is the risk of fraud related to Covid-19 support schemes – to what extent, if any, has the Audit Committee considered this?
 - Has there been an additional focus on going concern in your most recent audit? If so, why is this? (**Probe:** business conditions during the pandemic vs. new auditing standard on going concern.)

Sector developments (8–10 mins)

- Audit Quality Indicators (AQIs) are reported in the audit firms' annual transparency reports. Are you familiar with these indicators? Do you use these?
 - If so, how? Which are most useful and why? (**Probe:** discussing indicators with audit engagement partner in relation to current audit.)

- What, if anything, would make AQIs more useful to you? (*E.g. extended historical comparatives, the inclusion of benchmarks or targets, the inclusion of greater narrative explanation, comparison of indicators across firms.*)

Moderator note: Recently the government issued the audit reform consultation, listing a number of suggested reforms to audit. The consultation envisages the introduction of minimum standards for Audit Committees, initially applying to FTSE 350 companies only but potentially extended to all public interest entities in due course. The minimum standards are expected to cover the selection and oversight of the audit as well as the nature of Audit Committee reporting. Unlike the 'comply or explain' Corporate Governance Code, these standards will be mandatory.

- The government has proposed greater powers for the regulator to set standards for Audit Committees in relation to the oversight and selection of auditors, initially for FTSE 350 companies but this could be extended to Audit Committees of other Public Interest Entities. What would you hope to see from published standards? What could support Audit Committees and make it easy to comply?
 - What would a proportionate monitoring regime look like?
- Is there anything else you'd like to add that we haven't covered already?

Thank and close. Note down charity preference and registered charity number if possible.

Ask for any contacts for further interviews.