



May 2016

PwC LLP

Audit Quality Inspection

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The AQR's objective is to monitor
and promote improvements in the quality of auditing

About the FRC's Audit Quality Review team

Our objective

The FRC's mission is to promote high quality corporate governance and reporting to foster investment. The Audit Quality Review team (AQR) contributes to this objective by monitoring and promoting improvements in the quality of auditing.

What we do

AQR assesses the quality of the audits of listed and other major public interest UK entities and the policies and procedures supporting audit quality at the major audit firms in the UK. We also review audits of entities incorporated in Jersey, Guernsey or the Isle of Man whose securities are traded on a regulated market in the European Economic Area. We adopt a risk-based approach to our work and focus our reviews of individual audits on key areas specific to each review.

Our team

AQR consists of approximately 35 professional and support staff. Our inspection teams have extensive expertise with an average of 19 years post-qualification experience. Our audit quality review work is subject to rigorous internal quality control reviews. Independent non-executives oversee our work.

Working with Audit Committees (or equivalent bodies)

Audit Committees play an essential role in reviewing and monitoring the effectiveness of the audit process. We are committed to engaging with Audit Committees to improve the overall effectiveness of our reviews and to support our common objective of promoting audit quality. We speak with Audit Committee Chairs during the year as part of our work. We also send our reports on each individual audit reviewed to the Chair of the relevant Audit Committee (or equivalent body).

Priority sectors and areas of focus

Our priority sectors for inspection in 2015/16 were insurance; food, drink and consumer goods manufacturers and retailers; companies servicing the extractive industries; and business services. We reviewed a number of audits from these sectors at the firms, together with a number of first year audits which were identified as an area of focus given the extent of changes in auditors following increased audit tendering. We also paid particular attention to the audit of revenue recognition and complex supplier arrangements.

Thematic reviews

In addition to our annual programme of audit reviews, we undertake one or more thematic reviews each year. We review firms' policies and procedures in respect of a specific aspect of auditing, and their application in practice, enabling us to make comparisons between firms with a view to identifying both good practice and areas for improvement.

This year we have published reports on "Firms' audit quality monitoring" (January 2016) and "Engagement Quality Control Reviews" (February 2016). We expect all firms to take appropriate action to address the findings from our thematic reviews which apply to them.

Developments in Audit Quality 2015/16

In addition to reports on each of the major firms we have reviewed, the FRC intends to issue later in 2016 (and annually thereafter) a report on the quality of audit in the UK. This will include a report on the overall findings of our AQR activity.

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The AQR assesses the quality of audits and policies and procedures supporting audit quality at major firms

1 Overview

This report sets out the principal findings arising from the 2015/16 inspection of PricewaterhouseCoopers LLP (“PwC” or “the firm”) carried out by the Audit Quality Review team of the Financial Reporting Council (“the FRC”). We conducted this inspection in the period from February 2015 to January 2016 (“the time of our inspection”). We inspect PwC, and report publicly on our findings, annually.

Our report focuses on the key areas requiring action by the firm to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the firm’s audit work. Our findings cover matters arising from our reviews of both individual audits and the firm’s policies and procedures which support and promote audit quality.

Section 2 sets out our key findings requiring action and the firm’s responses to these findings.

Section 3 sets out our overall assessment of the quality of the audits we reviewed in our 2015/16 inspection and how it compares with our assessments for the previous four years.

Appendix A sets out our objectives, scope and basis of reporting.

Appendix B explains how we assess audit quality.

We acknowledge the co-operation and assistance received from the partners and staff of the firm in the conduct of our 2015/16 inspection.

Scope of our 2015/16 inspection

Our inspection comprised a review of the firm’s policies and procedures supporting audit quality and reviews of selected aspects of individual audits.

The areas covered by our review of the firm’s policies and procedures included:

- Tone at the top;
- Independence and ethics;
- Audit methodology, training and guidance; and
- The firm’s own audit quality monitoring.

We reviewed selected aspects of 25 individual audits in 2015/16. In selecting which aspects of an audit to inspect, we took account of those areas identified to be of higher risk by the auditors and Audit Committees, our knowledge and experience of audits of similar entities and the significance of an area in the context of the audited financial statements.

Key findings

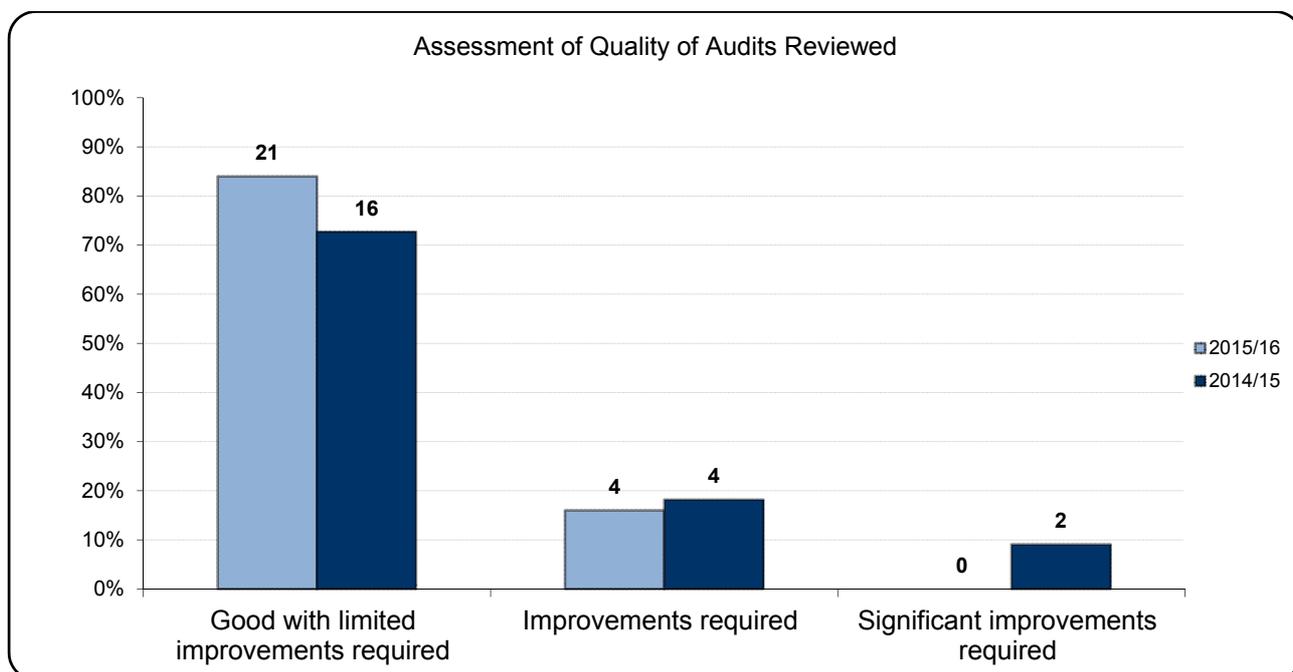
In response to the findings from our last inspection, the firm has implemented the agreed actions and has enhanced its procedures in the following areas:

- Methodology, guidance and training: there have been updates to the firm's audit manual and guidance, along with training in a number of areas, including the testing of IT controls and group audits.
- Independence procedures: the firm has strengthened certain independence monitoring procedures.
- Quality monitoring procedures: enhancements have been made to aspects of the firm's approach to quality monitoring.

Our key findings in the current year requiring action by the firm, which are elaborated further in section 2 together with the firm's actions to address them, are that the firm should:

- Improve the consistency of the extent of challenge of management in relation to areas of judgment, in particular for impairment reviews and tax provisions.
- Ensure data analytics is better integrated into the audit of revenue.
- Continue to make improvements to the audit of complex supplier arrangements.
- Ensure there is appropriate consideration of fraud risk characteristics when testing journals.
- Ensure that any significant changes from the proposed audit approach are communicated to the Audit Committee.
- Improve the accuracy or precision of the description of audit procedures performed in auditors' reports.
- Continue to strengthen the firm's monitoring of compliance with its independence policies and procedures and seek to reduce the number of independence breaches.

The following chart shows our assessment of the quality of the firm’s audits which we reviewed in 2015/16, with comparative information for 2014/15. Further details are provided in section 3.



The chart shows an overall improvement in our assessment of the quality of the specific audits we reviewed in 2015/16 compared with our assessment for those audits we reviewed in 2014/15. In particular, no audits were assessed as requiring significant improvement in 2015/16.

Section 3 sets out examples of good practice which contributed to audits being assessed as requiring no more than limited improvements. It also sets out the principal issues resulting in audits being assessed as requiring more than limited improvements.

We expect all the firms we inspect to make continuous improvements such that, by 2019, at least 90% of FTSE 350 audits reviewed will be assessed as requiring no more than limited improvements¹.

Root cause analysis

Thorough and robust root cause analysis is necessary to enable firms to develop effective action plans which are likely to result in improvements in audit quality being achieved. At our request, the firm has performed root cause analysis in respect of our key findings in this report.

¹ FRC Plan and Budget 2016/17

Firm's overall response and actions:

Audit quality remains of paramount importance to the firm. We strive for improvement in all aspects of our audit work and, as a result, we appreciate the independent insights provided by the inspections undertaken by the FRC.

We always take the observations and recommendations made by the FRC very seriously, and we have undertaken root cause analysis on the key findings, utilising our global methodology, to identify causal factors from which we then develop a detailed and responsive action plan. For the first time this year this inspection report includes a summary of the actions in that plan.

Our root cause analysis has identified specific causes contributing to individual findings and the actions we are taking in response are set out alongside those findings in section 2 of this report. In addition, our root cause analysis also identified actions which will contribute to more pervasive quality improvement. These are:

- We will re-emphasise to our auditors the importance of maintaining an adequately sceptical mindset at all times through the audit. This will feature throughout this summer's technical training programmes and will include utilising the ICAEW's recently released 'False Assurance' film. This film is designed to facilitate, amongst other things, consideration of how auditors should go about their work in a sceptical way.
- Effective coaching enhances audit quality and we will therefore remind engagement teams to ensure adequate consideration is given to how effective coaching is embedded in the delivery of their audit. In addition, a new series of development events, which include a focus on coaching, will be delivered this year and next to our core engagement team members.
- As with coaching, an effective review of our audit working papers by senior members of the team is essential to maintain audit quality. Our central quality team are undertaking a 'review project' to identify features of best practice and determine common areas of ineffectiveness. The resulting actions and behaviours engagement teams can take to improve in this area will be incorporated into our training programmes.
- Awareness of regulatory findings assists engagement teams in focusing on areas where audit quality improvements can be made. In June 2016 we will deliver a Regulatory Findings webcast, mandatory for audit staff from manager to partner, covering all key and other findings from the AQR inspection. Regulatory findings are also incorporated into other training programmes throughout the year, including our quarterly webcasts and annual training for Partners.

We are confident that these actions, together with the more detailed actions in respect of the key findings set out in section 2 of this report, will ensure our focus remains on delivering the highest quality audits.

2 Key findings requiring action and the firm's response

We set out below the key areas where we believe improvements are required to enhance audit quality and safeguard auditor independence. The firm was asked to provide a response setting out the actions it has taken or will be taking in each of these areas.

Improve the consistency of the extent of challenge of management in relation to areas of judgment, in particular for impairment reviews and tax provisions

An appropriate level of challenge of management is important in ensuring a high quality audit of areas of judgment, in particular for valuations and estimates. Effective audit teams will consider management's assumptions and compare these to available audit evidence and, where appropriate, challenge management in relation to the basis of those assumptions. The extent of reporting to the Audit Committee can also affect the effectiveness of their consideration of these areas.

Given the level of audit risk and the potential impact on the financial statements, the audit of valuations and estimates was reviewed by us on all the audits that we inspected and we identified a number of findings, including in particular:

- The extent to which the growth assumptions and related disclosures in impairment reviews had been adequately considered and challenged, including in situations where there were recent investments. For example, on one audit, the audit procedures performed in relation to the short-term growth assumptions to support the carrying value of recent investments appeared to focus mainly on discussions with management in respect of their plans. In addition, while the audit team informed the Audit Committee that management had agreed to expand the disclosures regarding the key assumptions in the financial statements, the expanded disclosures did not cover the short-term growth rates and related sensitivities.
- The extent of evidence to support long-standing tax provisions which had not moved for a number of years. For example, on two audits there was insufficient evidence supporting a number of long-standing tax provisions and the original basis for the provisions. On one of these audits, there was insufficient evidence that the audit team had challenged the judgments made for each exposure and jurisdiction.

Firm's actions:

Challenging management is at the core of having a sceptical mindset. Evidencing this challenge of management can be in itself a challenge. Over the last few years our training programmes have focused on ensuring that challenge made is evident on our audit files, and our use of a specific document to set out particular areas of scepticism has focused engagement teams on their need to capture the work performed appropriately on the audit file.

Our root cause analysis has determined that obtaining external evidence to support impairment reviews of intangible assets can be more challenging for business ventures in new markets where there is less of a track record to corroborate assumptions. In these circumstances, teams need to ensure sufficient and appropriate evidence has been brought together to support management's assertions. This is also the case when auditing provisions for uncertain tax positions where evidence may need to be accumulated and considered over a number of years.

We have developed a practice aid to assist engagement teams in identifying alternative sources of evidence to support impairment reviews. Our 2016 training programme will include specific audit training in respect of auditing such estimates, and further training will be undertaken by our audit of tax specialists to ensure sufficient audit evidence is obtained for long standing tax provisions.

Ensure data analytics is better integrated into the audit of revenue

Revenue is an important driver of an entity's operating results and auditors need to evaluate and address fraud risks in relation to revenue recognition. A failure to perform sufficient audit work in this area increases the risk that the auditors will not identify a material misstatement of revenue in the financial statements.

PwC has increasingly used data analytics to provide substantive audit evidence for revenue. The relevant approach is referred to by the firm as “revenue CAATs”, which matches revenue transactions to cash and other balances, and can be an effective audit approach when applied correctly. This approach relies on sufficient testing of cash and the other matched balances. The following matters were not adequately addressed on some of the audits we reviewed, where revenue CAATs were used:

- Revenue CAATs do not provide assurance over the completeness or classification of revenue transactions and additional audit procedures need to be performed in this respect. On one audit, there was insufficient evidence that the completeness of revenue had been adequately audited. On another audit, it was not clear that sufficient audit procedures had been performed to assess whether transactions had been correctly classified.
- Revenue CAATs can identify non-standard transactions (i.e. those not matched to cash or other related balances) and it is important that additional audit procedures are performed for these items. On one audit, it was not clear that sufficient audit procedures had been performed in relation to the non-standard transactions. On another two audits, the extent of testing for the non-standard transactions was based on a normal level of risk, even though the non-standard transactions, by their nature, potentially involved more risk.

Firm's actions:

Our root cause analysis identified that our recent technical training has focused on the identification of revenue risks and designing effective audit procedures to address heightened risks including fraud. Additional guidance was issued in September 2015 for teams using revenue CAATs to address the normal risk in revenue. This guidance was supported by amendments to our electronic work papers. Both emphasised the need for engagement teams to design an adequate approach to the testing of non-standard transactions, addressing the completeness assertion and classification testing.

Our summer training programmes will contain a practical session on the audit of revenue. This session will focus on how audit teams should develop and evidence their strategy for the audit of revenue and will include key messages and examples from this inspection.

Continue to make improvements to the audit of complex supplier arrangements

Complex supplier arrangements, such as volume and other types of rebates, can have a material impact on an entity's operating results. Auditors need to ensure they understand the impact of these arrangements on the financial statements.

We reviewed the audit of complex supplier arrangements for both suppliers (including manufacturers) and customers (including retailers). PwC issued specific guidance on this area at the beginning of 2015.

On most of the audits we reviewed, where applicable, there was an increased focus on complex supplier arrangements this year. However, there was a need for further improvement on certain audits, including the adequacy of audit procedures in relation to the following:

- **Completeness of rebates:** on one audit, which was undertaken before the firm's specific guidance was issued, there was insufficient evidence that the audit procedures had adequately addressed the completeness of rebates and discounts which had been netted off revenue.
- **Year-end rebate debtor and creditor balances:** on one audit, while the testing of supplier income deals throughout the year included some items that were settled post year-end, there was insufficient tracing of the year-end balances to the items tested. It was therefore difficult to assess whether the level of testing of those balances was sufficient.

Firm's actions:

Our specific guidance on complex supply arrangements was issued in response to market focus in this area. It was prescriptive as to expected risk assessment and responsive procedures. Adoption by our audit teams was immediate and led to an increase in focus in this area.

Our root cause analysis identified that the guidance was not always easy to apply, given different client approaches and group organisational structures. We identified a need to add an additional step in our audit file to assist teams in appropriately tailoring those procedures for their specific engagement. We will monitor the application of the guidance through our internal quality monitoring programme during June – August 2016.

Ensure there is appropriate consideration of fraud risk characteristics when testing journals

Auditors need to evaluate and address fraud risks in relation to the financial statements. Testing the appropriateness of journal entries recorded in the general ledger is one of the procedures required by auditing standards to respond to the risk of a material misstatement in the financial statements due to fraud.

While we have seen some improvement in this area, there needs to be more focus on identifying those fraud risk characteristics which are more likely to give rise to a material misstatement. On a number of audits reviewed, the fraud risk characteristics were not adequately considered when determining which journals should be tested.

Firm's actions:

Our 'Halo for Journals' tool allows us to analyse 100% of the population, enhancing the levels of coverage when compared with normal audit sampling techniques. As a consequence engagement teams may have used this increased capability to review the full population of journals, selecting for testing journals with unusual characteristics that are not necessarily those assessed in the original fraud risk analysis.

We have already issued further guidance to engagement teams on this topic, highlighting the required focus on fraud risk identification, and our Risk and Quality workshops in late 2015 discussed the practical challenges of fraud risk identification with engagement teams. We will augment this in 2016 by developing an additional practice aid demonstrating how the identified fraud risk tests within Halo are responsive to the potential fraud risks factors within ISAs (UK&I).

Ensure that any significant changes from the proposed audit approach are communicated to the Audit Committee

The increased tendering activity has resulted in more first year audits. The firm sets out details of the planned audit approach in its tender documents. It is important that any significant departure from the approach, as described in the tender document, is adequately explained and communicated to the Audit Committee so that they can consider the impact of the change in approach.

First year audits were identified as an area of focus for us this year and we reviewed two such audits undertaken by PwC. In one of these audits, the tender document referred to planned reliance on internal controls and the use of data analytics techniques. However, there was only limited testing of internal controls and use of data analytics. More details should have been provided to the Audit Committee about the actual audit approach undertaken.

On the other first year audit, the audit team did not adequately explain to the Audit Committee the reasons for a change in the level of performance materiality set, compared with the lower level communicated at the time of the audit tender.

Firm's actions:

Our audit proposals are developed at the onset of a relationship with a potential client and in advance of access to detailed successor auditor working papers and detailed management information. It is therefore inevitable that on appointment our audit approach develops between proposal, audit plan, final audit execution and completion.

We have reminded engagement leaders that appropriate explanations for significant changes in audit approach are provided to the Audit Committee during the audit process. We will update our Audit Committee reporting templates accordingly.

Improve the accuracy or precision of the description of audit procedures performed in auditors' reports

Extended auditors' reports have improved the transparency of the audit procedures performed in response to those risks identified by the auditors². It is important to ensure that the procedures performed are described accurately, so that users of the financial statements are properly informed of the audit approach taken to respond to those risks.

We have seen an increased level of detail this year in the descriptions of the audit procedures for areas of focus in auditors' reports, which we believe is a positive development. However, in some cases the accuracy or precision with which certain procedures were described needed to be improved. For example, on one audit, the auditors' report inaccurately stated that the short-term growth assumptions were supported by a comparison to historic performance by the auditors and that detailed disclosures regarding the key assumptions had been set out in the financial statements. On another audit, the procedures for the estimated costs to complete on long-term contracts stated in the auditors' report were not fully consistent with those actually performed.

Firm's actions:

Enhancing the description of our work within our audit reports has been a continual focus as expectations and guidance have developed.

We updated our policy and guidance in this area in December 2015, reemphasising the need for engagement teams to map the described audit procedures to the supporting audit work. These methodology amendments were reinforced by specialists hosting calls with audit teams to explain the updates. Additional working papers were also introduced into our audit files to ensure engagement teams understand the level of precision required and record this work appropriately.

Continue to strengthen the firm's monitoring of compliance with its independence policies and procedures and seek to reduce the number of independence breaches

Insufficient monitoring of compliance with the firm's independence policies and procedures, in order to identify or prevent breaches, could compromise the firm's independence and objectivity.

The firm maintains a log of independence breaches, which identified a higher number of breaches of Ethical Standards in the year to 30 September 2015 than in the prior year. Nearly all of these related to the holding of prohibited investments and the late approval of non-audit services, being the same areas as last year.

Some of these holdings of prohibited investments had not been self-declared by the relevant partners and were identified through the firm's independence testing, which covers the financial interests of approximately 10% of the partners each year, with additional testing of new partners. The firm should review the scope of its testing in this area and should consider testing a higher proportion of partners each year.

One reason for the holdings of prohibited investments was the firm's Central Entity System (CES) not having been updated on a timely basis. Partners and staff are responsible for recording their

² The FRC published a report on the second year of extended auditor's reports in January 2016: "Extended auditor's reports: A further review of experience".

financial interests on the firm's Checkpoint system, which relies on CES being up to date, so that any prohibited investment can be identified. CES contains information about securities issued by audited entities and audit teams are responsible for keeping it up-to-date. While the firm has updated its procedures to ensure the CES system is updated on a timely basis, these changes had not fully taken effect at the time of our inspection.

The independence breaches arising from the late approval of non-audit services were identified as part of the firm's internal quality review process. Improvements should be made to ensure that non-audit services are not provided until the audit partner's approval is obtained.

At the time of our review, the firm's log of independence breaches did not include all potential breaches under consideration by the firm but we were informed that no other types of breaches were identified or under consideration. We identified a breach of a technical nature, however, relating to an audit partner joining an audited entity in a senior role (in 2013), shortly before the expiry of the required two year cooling-off period since his last involvement on the audit of certain material subsidiary entities. This matter should have been identified by the firm at the time (before the date from which he could take up the role was agreed).

Firm's actions:

Improving our independence compliance continues to be a key focus for the firm.

In each of the past two years, when considering the extent of all the procedures undertaken, approximately 25% of partners have been subject to independence testing. Going forward we will review the scope of our annual testing programme, continuing to ensure an appropriate proportion of partners are tested frequently.

With respect to CES, we issued a new system user guide and are also developing a new specific CES training module for relevant staff. These both highlight the need for accuracy within the client CES profile and the responsibilities of the audit engagement team in maintaining these records. The requirement to maintain CES data has been a regular feature of our communications to the practice over the past 12 months. Furthermore, we implemented a centralised quarterly review control in November 2015 whereby the CES records for all new public interest entity audits are reviewed for accuracy.

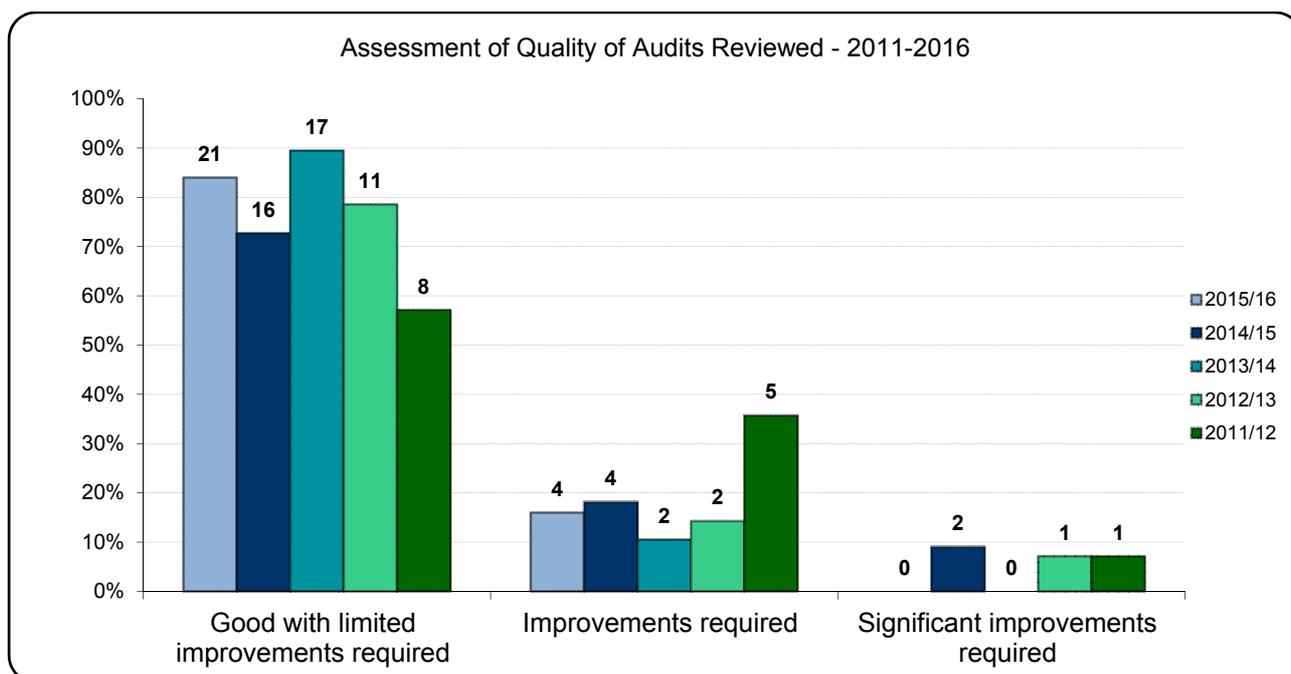
A reminder of the importance of obtaining timely approval from the engagement leader for non-audit services has been included in the firm's 2016 Annual Risk and Quality training programme, completed by staff and partners in all lines of service (consulting, deals assurance and tax). Reminders will also be included in each line of service training programme and will be monitored as part of the internal quality review process.

We will continue to log all identified independence breaches on the independence log.

3 Assessment of the quality of audits reviewed

We reviewed selected aspects of 25 individual audits in 2015/16. Of these, two were first year engagements.

The bar chart below shows the results of our assessment of the quality of the audits we reviewed in 2015/16, with comparatives for the previous four years³. The number of audits within each category in each year is shown at the top of each bar.



We identified the following examples of good practice in 2015/16 which contributed to audits being assessed as requiring no more than limited improvements:

- The extent and quality of testing of IT and other controls.
- The extent of direction and oversight of the work of component auditors.
- The quality of written communications with Audit Committees.

The principal issues resulting in four audits being assessed as requiring more than limited improvements in 2015/16 included the following (further details of which are set out in section 2):

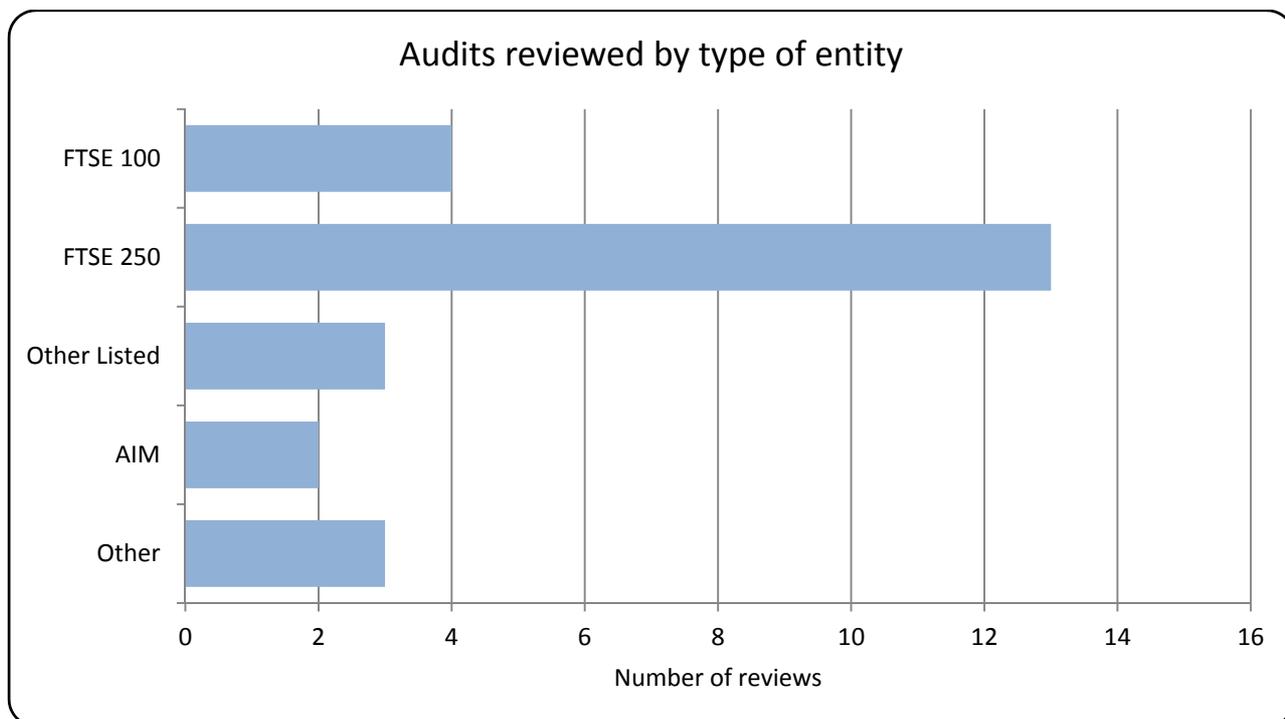
- Insufficient consideration and challenge of management in relation to impairment reviews.
- The application of data analytics in the audit of revenue.
- Deficiencies in the audit of complex supplier arrangements.

³ Changes to the proportion of audits falling within each category from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For this reason, and given the sample sizes involved, changes from one year to the next are not necessarily indicative of any overall change in audit quality at the firm.

Audits inspected in 2015/16

We estimate that the firm audited 540 UK entities within the scope of independent inspection as at 31 December 2014. Of these entities, our records show that 223 had securities listed on the main market of the London Stock Exchange, including 35 FTSE 100 and 50 FTSE 250 companies.

The following chart provides a breakdown of the audits inspected in 2015/16 by type of entity⁴:



Audit Quality Indicators

The firm's transparency report for the year ended 30 June 2015 includes certain Audit Quality Indicators (AQIs) which the six largest audit firms are using. We believe that such AQIs provide useful additional information to those wishing to understand firms' approaches to monitoring and improving audit quality.

We are pleased that firms have made a good start in identifying and monitoring AQIs. We would, however, encourage them to gather the relevant data on a more consistent basis and follow-up the results more effectively.

Audit Quality Review

FRC Audit Division

May 2016

⁴ The listed entities whose audits we reviewed include four investment trusts or similar entities.

Appendix A – Objectives, scope and basis of reporting

Matter	Explanation
Objectives of our inspection	<p>The overall objective of our work is to monitor and promote improvements in the quality of auditing. As part of our work, we monitor compliance with the regulatory framework for auditing, including the Auditing Standards, Ethical Standards and Quality Control Standards for auditors issued by the FRC and other requirements under the Audit Regulations issued by the relevant professional bodies. The standards referred to in this report are those effective at the time of our inspection, or, in relation to our reviews of individual audits, those effective at the time the relevant audit was undertaken.</p>
Audits in the scope of our inspection	<p>In addition to the UK audits in scope, as stated in section 3 of our report, the UK firm audits a number of entities incorporated in Jersey, Guernsey or the Isle of Man whose securities are traded on a regulated market in the European Economic Area. These audits are inspected by us under separate arrangements agreed with the relevant regulatory bodies in those jurisdictions. The results of these reviews are included in this report. Our records show that, at the time of our inspection, the firm had nine such audits, including two FTSE 100 companies.</p> <p>PwC also supplies audit services to local authorities and the NHS (Local Public Audits - LPAs). Whilst we review LPAs undertaken by firms, this is done under separate arrangements agreed with the Public Sector Audit Appointments Limited (PSAA), previously the Audit Commission. The results of these reviews are not included in this report because the LPA inspections fulfil a different purpose to those considered in this report. These reviews of LPAs form part of the PSAA's assessment of the quality of contracted-out audits. The PSAA publishes its assessment both in overall terms and individually by firm. The most recent reports can be found on its website.</p>
Impact of our risk-based inspection approach	<p>Our inspection was not designed to identify all weaknesses which may exist in the design and/or implementation of the firm's policies and procedures supporting audit quality or in relation to the performance of the individual audit engagements selected for review and cannot be relied upon for this purpose.</p>
Key audit areas inspected	<p>In selecting which aspects of an audit to inspect, we take account of those areas considered to be higher risk by the auditors and Audit Committees, our knowledge and experience of audits of similar entities and the significance of an area in the context of the audited financial statements. The rationale for including each area of audit work (or excluding any area of focus listed in the auditors' report) is documented as part of the planning process for each audit inspected.</p>
Our reports on individual audits	<p>We issue a report on each individual audit reviewed during an inspection to the relevant audit engagement partner or director and the chair of the relevant entity's Audit Committee (or equivalent body).</p>
Our emphasis on improvements to audit quality	<p>We seek to identify areas where improvements are, in our view, needed in order to safeguard audit quality and/or comply with regulatory requirements and to agree an action plan with the firm</p>

Matter	Explanation
	designed to achieve these improvements. Accordingly, our reports place greater emphasis on weaknesses identified which require action by the firm than areas of strength and are not intended to be a balanced scorecard or rating tool.
Basis of our public reporting	While our public reports seek to provide useful information for interested parties, they do not provide a comprehensive basis for assessing the comparative merits of individual firms. The findings reported for each firm in any one year reflect a wide range of factors, including the number, size and complexity of the individual audits selected for review which, in turn, reflects the firm's client base. An issue reported in relation to a particular firm may therefore apply equally to other firms without having arisen in the course of our inspection fieldwork at those other firms in the relevant year. Also, only a small sample of audits is selected for review at each firm and the findings may therefore not be representative of the overall quality of each firm's audit work.
Purpose of this report	This report has been prepared for general information only. The information in this report does not constitute professional advice and should not be acted upon without obtaining specific professional advice. To the full extent permitted by law, the FRC and its employees and agents accept no liability and disclaim all responsibility for the consequences of anyone acting or refraining from acting in reliance on the information contained in this report or for any decision based on it.
Inspection findings included in our public report	We exercise judgment in determining those findings to include in our public report on each inspection, taking into account their relative significance in relation to audit quality, in the context of both the individual inspection and any areas of particular focus in our overall inspection programme for the year. Where appropriate, we have commented on themes arising or issues of a similar nature identified across more than one audit.
Inspection of audits outside our scope	The professional accountancy bodies in the UK register firms to conduct audit work. Their monitoring units are responsible for monitoring the quality of audit engagements falling outside the scope of our work but within the scope of audit regulation in the UK. Their work, which is overseen by the FRC, covers audits of UK incorporated companies and certain other entities which do not have any securities listed on the main market of the London Stock Exchange and are not otherwise defined as being within the scope of our work.
	All matters raised in this report are based solely on the work which we carried out for the purposes of our inspection.

Appendix B – How we assess audit quality

We assess the quality of the audit work we inspect using the following four categories:

- Good (category 1);
- Limited improvements required (category 2A);
- Improvements required (category 2B); and
- Significant improvements required (category 3).

The assessments of the quality of the audits we reviewed in our public reports on individual firms combine audits assessed as falling within categories 1 and 2A.

These four categories have been used consistently since 2008, although there have been some minor refinements to the category descriptions over the years. They reflect our assessment of the overall significance of the areas requiring improvement that we have reported to the Audit Committee and the auditor. We expect the auditor to make appropriate changes to its audit approach for subsequent years to address all issues raised.

An audit is assessed as good where we identified no areas for improvement of sufficient significance to include in our formal report. Category 2A indicates that we had only limited concerns to report. Category 2B indicates that more substantive improvements were needed in relation to one or more issues reported.

An audit is assessed as requiring significant improvements (category 3) if we have significant concerns in relation to the sufficiency or quality of audit evidence, the appropriateness of key audit judgments or other matters identified. In such circumstances we may request some remedial action by the firm to address our concerns and to confirm that the audit opinion remains appropriate. We will generally review a subsequent year's audit to confirm that appropriate action has been taken.

We exercise judgment in assessing the significance of issues identified and reported. Relevant factors in assessing significance include the materiality of the area or matter concerned, the extent of concerns regarding the sufficiency or quality of audit evidence, whether appropriate professional scepticism appears to have been exercised, and the extent of non-compliance with Standards or a firm's methodology.

Our inspections focus on how selected aspects of a particular audit were performed. They are not designed to assess whether the information being audited was correctly reported. An assessment that an audit required significant improvements, therefore, does not necessarily mean that an inappropriate audit opinion was issued, the financial statements failed to show a true and fair view or that any elements of the financial statements were not properly prepared.

Equally, where we have assessed an audit as requiring significant improvements, this does not necessarily imply potential misconduct on the part of an individual or audit firm which may warrant investigation and/or enforcement action by the FRC.



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