The FRC

Our purpose is to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them.

We have responsibility for the public oversight of statutory auditors.

The FRC works with European, US and global regulators to promote high quality audit and corporate reporting.

AQR

We monitor the quality of UK Public Interest Entity audits.

We promote continuous improvement in audit quality.

Our team of over 50 professional and support staff has extensive audit expertise to provide rigorous inspection of audit firms.

The Firm

PwC has 515 audits within the scope of AQR inspection, including 28 FTSE 100 and 62 FTSE 250 audits.

Our inspection process

There are around 3,000 audits within the scope of AQR inspection. Of these, we inspected 130 audits in 2019/20, including the 17 PwC audits covered by this report.

We work closely with audit committee chairs to improve the overall effectiveness of our reviews.

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

We consider whether action under the FRC’s enforcement procedures is appropriate for all reviews assessed as requiring improvements or significant improvements. In practice, audits assessed as requiring significant improvement, and some of those assessed as requiring improvement, will be referred to the FRC’s Case Examiner for consideration of further regulatory action. The Case Examiner will consider the most appropriate action, including Constructive Engagement with the audit firm or referral to the FRC’s Conduct Committee for consideration of whether to launch a full investigation. This may result in a sanction being imposed and enforced against a statutory auditor and/or the audit firm in accordance with the FRC Audit Enforcement Procedure.

This report sets out the principal findings arising from the 2019/20 inspection of PricewaterhouseCoopers LLP (“PwC” or “the firm”) carried out by the Audit Quality Review team (“AQR”) of the Financial Reporting Council (“the FRC”). We conducted this inspection in the period from February 2019 to May 2020 (“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.

High quality audit is essential to maintain investor confidence by providing an independent, impartial view of a company’s financial statements. Poor auditing may fail to alert management, shareholders and other stakeholders to material misstatements (including those arising from fraud) or financial control weaknesses, in those cases where management have not identified or appropriately amended them. The combination of management not meeting their responsibilities in this respect and poor auditing could potentially put businesses and jobs at risk. High quality audit matters and we will drive audit firms to implement the necessary changes to reach the required standards.

Our priority sectors for inspection in 2019/20 were Financial Services, General Retailers, Business Support Services, Construction and Materials, and Retail Property. Of the 108 audits that we reviewed in the year across all firms (excluding Local Audit inspections), the number in priority sectors was: Financial Services – 18, General Retailers – 16, Business Support Services – 6, Construction and Materials – 3, and Retail Property – 8. We also paid particular attention to the following areas of focus: going concern and the viability statement, the other information in the annual report, long-term contracts, the impairment of assets and fraud risk assessment.
Our assessment of the quality of audits reviewed

All reviews – for the seven firms inspected annually

An audit is assessed as good or limited improvements required where we identified either no or only limited concerns to report. Improvements required indicate that more substantive improvements were needed in relation to one or more issues. Significant improvements required indicate we had significant concerns, typically in relation to the sufficiency or quality of audit evidence or the appropriateness of key audit judgements.

FTSE 350 reviews – for the seven firms inspected annually

Due to resourcing constraints, we reviewed fewer audits overall than in recent years. Across all firms, we completed 130 audit inspections compared to 160 in 2018/19. We did broaden the scope of our reviews to include more aspects of the audit, including the auditor’s response to fraud risk. Changes to the proportion of audits falling within each grading category reflect a wide range of factors, including the size, complexity and risk of the audits selected for review and the scope of individual reviews. Our inspections are also informed by the priority sectors and areas of focus referred to above. We are also cognisant, when making our selections, of the Competition and Market Authority’s recommendation that FTSE 350 entity audits should be subject to inspection approximately every five years. For these reasons, and given the sample sizes involved, our inspection findings may not be representative of audit quality across a firm’s entire audit portfolio; nor do small year-on-year changes in results necessarily indicate any overall change in audit quality at the firm. Nonetheless, any inspection cycle with audits requiring more than limited improvements is a cause for concern and indicates the need for a firm to take action to achieve the necessary improvements.
1 Overview

Commentary on our inspection work at the largest audit firms

Overall, 59 (67%) of the 88 audits reviewed in our 2019/20 inspection cycle, across the seven firms inspected annually, required no more than limited improvements. The number of audits requiring more than limited improvements, 29 (33%), remains unacceptable.

Firms have made some improvements and we have observed good practices (for example, better group audit oversight and effective integration of specialists into the audit team at some firms). We acknowledge the steps taken by firms seeking to address the key findings in our 2019 public reports.

However, firms are still not consistently achieving the necessary level of audit quality. They need to make further progress. For example, we continue to find improvements needed in the same three audit areas: impairment of goodwill and intangibles; revenue and contracts; and provisions, including loan loss provisions. Over the past three years, 76 of the 166 (46%) of the findings driving reviews requiring more than limited improvements have been in these areas. These findings often relate to insufficient challenge of, and standing up to, management in areas of complexity and forward-looking judgement. Other audit areas in which we had findings for more than one firm this year include: audit of inventory, group oversight, going concern and investment property valuations.

We take robust action for all reviews assessed as requiring improvements or significant improvements. To date, for the past three inspection cycles, we have referred 28 audits, across all firms inspected, for consideration of possible enforcement action.

We focused this year on key firm-wide procedures to improve audit quality, including firms’ audit improvement plans and their processes to analyse the root causes of audit failings. We have raised findings in these areas to help firms build more effective quality improvement processes going forward. We will continue to focus on ensuring that the firms develop their vital root cause analysis processes to identify areas for improvement and implement change on a timely basis.

We have seen some instances of good practice where audit teams have concerns with the most significant audit judgements. Firms’ senior management need to be clear that taking difficult decisions is an appropriate response to improving audit quality, even if it might sometimes mean delaying or modifying opinions, and ultimately losing some audit engagements. The tone from the top needs to support a culture of challenge and back auditors making tough decisions.

We are initiating a number of significant changes to improve audit quality, including:

- Increasing our focus on proactive supervision of the large audit firms. We will identify priority areas to improve audit quality, request the firms to implement suitable actions to achieve them and hold the firms accountable for delivery.
• Moving ahead with plans to increase the transparency of our audit quality assessments through publishing the scope and key findings of each of our individual audit inspections. We plan to publish our first set of these reports, where we have obtained the consent of the audit firm and the audited entity, next year alongside these annual reports on each of the largest audit firms.

• Asking the Big 4 firms, beginning from 2021, to implement operational separation of audit practices from the rest of the firm, so that the audit practices are focused above all else on achieving high audit quality.

• Strengthening the AQR team to increase the number of inspections in our 2020/21 cycle. We inspected a limited number of private companies and significant overseas components of groups during 2019/20, in line with the recommendations of the Kingman Review, and we will build on this as part of our overall target of 145-165 inspections for 2020/21.

We wrote to the major audit firms in December 20191 setting out elements that we observe consistently on high quality audits, especially on high risk engagements. The hallmarks of such audits include:

• Significant involvement of partner and other senior team members.

• Good use of specialists.

• Consultation on complex areas.

• Challenge of management leading to changes where assumptions are too optimistic.

• Robust quality control procedures.

• Clear and timely communication to Audit Committees.

We recognise the challenges posed currently by the Covid-19 pandemic, both in relation to the level of uncertainty surrounding forward estimates and projections, and inability to carry out physical procedures (for example, stocktakes). We will consider such matters carefully during our 2020/21 inspection cycle.

Audit selections

In recent years we have selected for inspection an increasing number of ‘higher-risk’ audits. Reliable reporting and high-quality audit matter most for these companies. This year 42 of the 108 inspections (39%), excluding public sector reviews, were higher risk compared to 32% in the previous year. We define audits as higher risk where the group or entity: is in a high-risk sector or geography; is experiencing financial difficulties; has balances with high estimation uncertainty; or where the auditor has identified governance or internal control weaknesses. Higher-risk engagements frequently require audit teams to assess and conclude on complex judgemental issues, for example:

• Materiality becomes a key factor in determining the significance of audit judgements for entities that have low profitability.

• Headroom on impairment assessments may be lower and the entity’s balance sheet may be more sensitive to changes in key assumptions.

• Going concern assessments are less clear cut.

Rigorous challenge of management and the application of professional scepticism are therefore especially important.

Perhaps because higher-risk audits are more challenging, we find that their audit quality tends to be lower. Of the audits that required more than limited improvement this year, we had identified almost half as higher risk. This year 40% (47% last year) of the audits that we identified as higher risk were assessed as requiring improvement, compared with 27% (13% last year) of audits not identified as higher risk.

Other factors that may lead both audit quality and our inspection results to vary over time include:

• The economic cycle: audit can be more difficult in an economic downturn when corporate profitability is lower.

• Changes in accounting, auditing and ethical standards: new standards can require more complex and forward-looking estimates which are more difficult to prepare and audit. Examples in recent years include forward-looking provisioning under IFRS 9 and assessing progressive revenue recognition under IFRS 15.

We have increasingly focused on higher-risk audits because they are where reliable reporting and high-quality audit matter most. Firms must perform audits to the same high standards regardless of the risks associated with the audited entity and the difficulty of the audit work.

We accept that our increased focus on higher-risk audits means that the grade profile of our inspection findings may be less representative of audit quality across the whole portfolio of an audit firm. The change in our approach to audit selection over time also means that historical comparisons of results need to be treated with care.
PwC overall assessment

We reviewed 17 individual audits this year and assessed only 11 (65%) as requiring no more than limited improvements. Of the 12 FTSE 350 audits we reviewed this year, we assessed only eight (67%) as achieving this standard.

The firm has taken steps to address the key findings in our 2019 public report, with actions that included increased resources and enhanced training. We have identified improvements, for example in the audit of revenue, a key finding last year. We also identified good practice in a number of areas of the audits we reviewed (including the use of internal specialists and experts) and in the firm-wide procedures (including initiatives to change behaviours relating to the challenge of management).

The most recurring findings that contributed to these results related to the challenge of management’s cash flow forecasts, primarily used in impairment reviews.

We have highlighted in this report aspects of firm-wide procedures which should be improved, including increasing the number and depth of in-flight reviews. PwC introduced its Programme to Enhance Audit Quality (“PEAQ”) in Summer 2019, to improve audit quality. The firm has implemented the plan on a phased basis to ensure that it is manageable and achievable. Given when the plan was introduced, it will not have had any impact on the audits we reviewed in this inspection cycle. Some of the initiatives will also take time to embed fully.

The overall inspection results remain unsatisfactory and we expect the firm to take specific action to address this. We will continue to review the progress of the firm’s PEAQ and plan to inspect a higher number of its audits proportionately in our 2020/21 cycle than at some other firms.
Our assessment of the quality of audits reviewed

PwC LLP – All inspections

Our key findings related principally to the need to:

- Improve the challenge of short-term cash flow forecast growth assumptions in relation to impairment reviews and going concern assessments.
- Enhance the challenge and supporting evidence in relation to the audit of long-term contracts.
- Enhance the audit work performed for the valuation of certain pension, property and intangible assets.
- Further improve group audit teams’ direction and supervision of component audit teams.
Good practice observations

We identified examples of good practice in the audits we reviewed, including the following:

• The scoping of audit work on first year audits
• The use of and interaction with the firm’s internal specialists and experts
• The quality of the firm’s summaries of audit responses to significant risks and related findings
• The quality of written communications with Audit Committees

Further details of our findings on our review of individual audits are set out in section 2, together with the firm’s actions to address them, as well as details of the good practices identified in those audits.

Review of firm-wide procedures

This year, our firm-wide work focused primarily on the following areas:

• Partner and staff matters relating to the 2018 performance year.
• Acceptance and Continuance (A&C) procedures.
• Audit quality initiatives.
• Root Cause Analysis (RCA) process.

The reason for the focus on RCA and audit quality initiatives is the importance of taking effective actions to address recurring inspection findings.

Our key firm-wide findings in these areas related principally to the need to:

Partner and staff matters

• Improve the consideration of audit quality in relation to relevant metrics in staff appraisals and the senior staff promotion process.

A&C procedures

• Improve the acceptance and continuance (A&C) system to enable it to more fully record and explain the conclusions.

Audit quality initiatives

• Increase the number and depth of in-flight reviews (internal reviews undertaken during the audit).
• Enhance project management procedures, such as through a formal milestone program.
**RCA process**

- Further improve the RCA process, in particular in relation to the scope of AQR category 3 inspections and the timing of the RCA reviews.

**Independence – non-audit services approval**

- Further strengthen the approval process for non-audit services for audited entities.

**Good practice observations**

We identified examples of good practice in our review of firm-wide areas, including the following:

- Partner and staff appraisals: consideration of audit quality in partner appraisals.
- A&C procedures: notification of entities that should not be accepted as an audit (“black box” list) available to the firm’s network.
- Audit quality initiatives: implementing new critical behaviours into the audit practice, including challenge of management, and increased central support through the Chief Auditor Network.
- RCA process: focused group sessions and the use of behavioural specialists.

**Firm’s internal and ICAEW quality monitoring results**

This year we have included, in each of our public reports, summary results of the firm’s internal inspection results, together with, where performed, those of the ICAEW’s latest quality monitoring. We consider that these results provide additional relevant information in relation to the assessment of the firm’s audit quality.

The results of the firm’s internal inspection results together with those of the ICAEW’s latest quality monitoring are set out in Appendix 1.

**Results of RCA and firm’s related actions**

Thorough and robust RCA is necessary to enable firms to develop effective action plans which are likely to result in improvements in audit quality being achieved.

In section 3 we have commented on the firm’s 2018/19 RCA processes, based on our review of them earlier in the inspection cycle. The firm has since performed RCA in respect of our current findings and considered the outcome in developing the actions included in this report. We have reviewed the results (and related processes) of this and set out our key observations below, including whether there have been improvements in the related RCA processes since our review earlier in the year:

- There has been an improvement in the RCA-related processes mentioned in section 3, including the scope of reviews of grade 3 rated engagements and the timing of RCA reviews.
- The RCA themes are set out in a good level of detail in the firm’s RCA report and PwC has a good process to consolidate the RCA findings into themes.
• Unlike some other firms, PwC reports separately on RCA reviews for internal and external inspection findings, rather than report on the themes on a consolidated basis. Also, there is less focus on good practice compared with some other firms.

• The firm’s actions have been set out by the firm in a good level of detail and are clearly linked to the identified RCA themes. We will review how any additional planned actions are incorporated into the firm’s audit quality plan (PEAQ) once this has happened.

We will continue to assess the firm’s RCA process and encourage all firms to develop their RCA techniques and responsiveness of actions further.

**Firm’s overall response and actions:**

We are disappointed with the outcome of this year’s inspection results and that we have not consistently achieved the high standards that we set for ourselves. Emerging findings from the 2019/20 inspection cycle contributed to the development of the firm’s Programme to Enhance Audit Quality (PEAQ) which was launched in June 2019. This three year programme includes a wide-ranging and fundamental package of measures, with the single objective of delivering consistently high quality audits. As the AQR’s report notes the programme will not have had an impact on the audits inspected in this cycle. We have made significant progress since the start of the programme and remain committed to continued focus and investment in this programme over the next two years.

The implementation of the PEAQ is led by the Audit Executive with progress monitored by our Executive Board and our Public Interest Body. PEAQ activities are structured under four workstreams – Structure and Governance, Culture and Recognition, Quality Control Activities and Supply and Demand. Activities continue to evolve as the programme progresses, feedback is obtained from stakeholders and the AQR, or Root Cause Analysis (RCA), identifies further required actions.

Many of the risk factors (which drive causal themes) and good practice examples identified in our RCA are, to a large extent, addressed by the activities in the workstreams in PEAQ. These include:

**Audit team resourcing**

Our RCA concluded that audit teams identify resourcing as the most significant challenge to delivering high quality audits, with our good practice examples undertaken by teams with the highest combination of engagement continuity and previous relevant audit experiences. The PEAQ Supply and Demand workstream includes a commitment by our Audit Executive to increase the capacity of our Audit business through recruiting an additional 500 experienced auditors by the end of FY21. This has been an area of considerable focus over the past 12 months, with good progress having been made against headcount targets. Following this year’s inspection, the Supply and Demand workstream will reconsider the balance of skills required by our junior auditors to consistently deliver high quality audits, and the mechanisms by which these skills are recruited and/or developed. Our RCA has emphasised the importance of not only increasing the number of auditors but also how they are deployed, for example through continuity of staffing and having relevant industry or sector experience.
A team of operational excellence specialists are currently undertaking a strategic review of our resourcing team structure and resourcing processes to identify how we can improve consistency across our audit resourcing function, support more effective resourcing decisions, and develop improved management information. The identified risk factors and good practice insights from the RCA will feed into phase two of the project, which will focus on the granular activities delivered by the function at an individual engagement level.

One of the aspects of our supply and demand workstream is the continued review of our portfolio of audited entities with an expectation that we would exit a number of audit engagements where resource capacity, risk or return issues exist.

**Auditor behaviours, challenge and mindset**

Following the findings from Professor Karthik Ramanna’s independent paper on the culture of challenge, the PEAQ Culture and Recognition workstream identified certain ‘critical few behaviours’. ‘Critical few behaviours’ is the terminology in behavioural theory for the most important behaviours which will have a significant impact on performance when exhibited by a large number of people. We have identified ‘team first’, ‘challenge and be open to challenge’ and ‘take pride’ as the critical behaviours which will have the greatest impact on improving audit quality and these have been at the heart of Audit leadership communications and people processes this year. Our RCA identified that in our good practice examples teams demonstrated the critical few behaviours consistently, both during the course of the audit and during the inspection process.

The ‘challenge and be open to challenge’ behaviour has resonated with our engagement teams and gives them ‘air cover’, the authority and support from leadership, to challenge unacceptable expectations from audited entities and poor quality audit evidence provided by them. The quality and timeliness of deliverables provided by audited entities varies widely. Our RCA identified that engagement teams have a tendency to accept this, rather than challenging the quality of what has been received, primarily as a consequence of challenging audit timelines or consistency with what has been received in the past. In our good practice examples, teams identified high quality, timely deliverables as having a positive influence on their audit effectiveness, whereas late receipt of deliverables may result in engagement teams working under significant time pressure to meet reporting deadlines.

The ‘take pride’ and ‘team first’ critical few behaviours encourage the important behaviour of in-team coaching and knowledge sharing, self-review and timely audit working paper review. Coaching, oversight and supervision of audit team members is important on all audits and forms the basis for our learning and quality model, and we identified challenges where coaching was not responsive to the nature or extent of audit evidence obtained or was not sufficiently prioritised. We also identified that our junior team members need further support in capturing relevant audit evidence with clarity on the audit file, further emphasising the importance of coaching within our audit teams.

The PEAQ Culture and Recognition workstream has placed the critical few behaviours at the centre of the performance assessment, progression and promotion processes, to emphasise the importance of these activities.
**Lack of Auditor confidence**

We have identified a growing uncertainty within audit teams as to how much evidence is required to support an auditor judgement, and this uncertainty undermines auditor confidence. As part of the PEAQ we established a Chief Auditor Network (CAN) to provide ‘desk side’ practical and technical support to audit teams. The CAN is made up of experienced auditors with a presence in every office and business unit and the support they provide will help improve aspects of auditor confidence.

We are also taking a number of actions in respect of auditor reward and recognition to underpin the expectation of high quality audit work, to improve both auditor confidence and deliver a sustainable improvement in the delivery of consistently high quality audits.

**Project Management**

We identified that where a significant or unplanned concentration of audit activities was undertaken in the peak phase of an audit and/or there was limited auditor capacity to respond to challenges arising, an audit team’s ability to sufficiently evidence procedures is restricted. Our good practice examples identified that a continued focus on project management throughout the audit helps anticipate and alleviate this concentration.

Included within the PEAQ is a focus on how teams structure, manage and deliver their audits, and enhancing our audit teams project management skills. The objective is to drive earlier completion of key milestones, refocus planning activities to drive greater consistency in the use of the distributed delivery model (our Centre of Excellence and Delivery Centres) and technology, and improve project management discipline and training, including better task and review activity planning at a sufficient level of granularity. A phased implementation, focused on planning milestones, is being piloted with selected teams in 2020. It is expected that all teams will be required to meet new planning milestones from 2021.

Details of our additional actions in response to the key findings are set out in the relevant sections of this report.

We will monitor closely the promptness and effectiveness of the firm’s actions. Should these not address our concerns adequately, we will consider what further steps we need to take to both safeguard and improve audit quality.
2 Review of individual audits

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

Improve the challenge of short-term cash flow forecast growth assumptions in relation to impairment reviews and going concern assessments

The assessment of potential impairment in goodwill and other assets (including retail stores), as well as the going concern assumption, often requires the estimation of future cash flows. These may involve significant judgement and potential management bias. Auditors should obtain sufficient and appropriate evidence to assess the reasonableness of forecast cash flows and challenge these assumptions to support their conclusions over the extent of impairment and the appropriateness of the going concern assumption.

Key findings

We reviewed the audit of impairment of goodwill and other assets (including retail stores), and the going concern assumption, on all audits where the audit team identified this as heightened audit risk. We identified the following findings relating to the consideration of the future short-term cash flow growth assumptions:

• In relation to impairment reviews for goodwill and other assets, on five audits, while the audit teams discussed the short-term cashflow assumptions with management, they did not adequately challenge or corroborate the extent of growth in the forecasts. In addition, on some of these audits, the audit team did not sufficiently assess management’s historical cash flow forecasting accuracy (for example, limiting the assessment to one year) or the planned changes to the underlying business (such as cost reduction programs).

• In relation to retail stores, on one audit where management had undertaken impairment reviews for individual stores, the audit team did not challenge the appropriateness of using a standard growth rate across all stores. The audit team also relied on store contribution reports for allocation purposes, without adequate testing of those reports. On another audit, the audit team did not adequately justify the allocation of a category of sales for the purposes of allocating future cash flows in the impairment reviews.

• On one audit where going concern was identified as a significant risk, the audit team did not test the short-term cash flows in sufficient detail.

The extent of challenge of cash flow forecast assumptions has also featured in past inspections. The firm has implemented a number of actions, including additional training and further guidance. However, in view of the recurring findings, the firm needs to provide a more robust response in this area.
Firm’s actions:

We recognise that the actions that we have taken as a result of previous inspections have not yet resulted in the level of high quality consistency that we require of ourselves. Although we note that the actions taken as a result of the 2018/19 inspection cycle will not have fully impacted the 2019/20 inspections, we are focussed on further improvements in this area.

Our RCA focused on the findings relating to audit procedures performed on cash flow forecasts used within management impairment assessments. The overarching factors in respect of resourcing, project management and timely high quality deliverables are fundamental to give audit teams appropriate opportunity to effectively capture their challenge of management’s assumptions within cash flow forecasting. We found examples of senior members of engagement teams having to focus singularly on significant audit issues and challenges late in the audit process. The overarching activities of PEAQ will have an impact on addressing these matters to allow appropriate challenge to be demonstrated.

In particular our RCA identified that our audit teams want more granular guidance on ‘auditing the future’ which will help them execute auditing procedures over cash flows with more confidence. Tools such as mandatory checklists, quick reference guidance (including FAQs, top tips and red flags) and flowcharts are effective support mechanisms to help engagement teams capture all relevant audit evidence at critical stages during audit execution. Furthermore, in response to both ongoing regulatory findings and the requirements of ISA (UK) 540 revised ‘Auditing Accounting Estimates and Related Disclosures’ (which is newly effective this year), we have updated our guidance, templates and workpapers in respect of estimates within cash flow forecasts. The new Chief Auditor Network and our Higher Profile Client (HPC) programme are also currently focussed on supporting engagement teams auditing challenging cash flow forecasts, and in particular in respect of impairment reviews.

Our RCA relating to the finding in respect of going concern concluded that our workpapers are not sufficiently tailored to respond to the designated audit risk assessment. We will develop a mandatory going concern checklist to be included on the audit file where the audit risk is heightened. Mandatory audit training on the requirements of ISA (UK) 570 'Going Concern' was delivered in 2019 and will again be a feature of our 2020 training together with the requirements of the revised standard (newly effective this year).

Enhance the challenge and supporting evidence in relation to the audit of long-term contracts

Accounting for long-term contracts, including revenue and profit recognition and the estimate of claims and variations, is highly judgemental and can be susceptible to management bias. Audit teams should apply an appropriate level of challenge and obtain sufficient and appropriate audit evidence in relation to the significant judgements in these areas.
Key findings

Given the potential impact on the financial statements, we reviewed the audit of long-term contracts on all audits where it was a significant risk. While we have seen improvements in this area compared with last year, we continued to identify instances of insufficient audit team challenge or corroboration, in relation to long-term contracts, in the following cases:

- For recognised contract claims (receivables) on one audit, which required significant improvements, the audit team had not sufficiently challenged management’s explanations or obtained adequate corroborating evidence to support the extent of the recognised claims on a significant contract. In addition, the audit team did not challenge the adequacy of the financial statement disclosures for claims.

- In relation to estimated future costs and margins, on three audits, there was inadequate testing or insufficient evidence of assessment of whether management had appropriately estimated costs to complete and profit margins.

The firm should consider whether assistance could be obtained from the firm’s experts (for example quantity surveyors) in relation to the audit of long-term contracts.

Firm’s actions:

We undertook RCA procedures with team members from across the AQR’s sample of contracting audit engagements, including those identified by the inspection team as including best practice, to understand the effectiveness of guidance and training undertaken on long-term contracting (including contract claims) during 2019 and where further action could be taken to improve those audits where findings had been noted. Although we are pleased improvements have been noted by the inspection team, from these activities, we identified that certain enhancements could be made to our long-term contract guidance around expected controls reliance, and in our control testing workpapers, to support consistent capture of all relevant considerations.

We also identified that in specific instances audit procedures, such as attendance at contract review meetings, were being performed by junior staff, without sufficient oversight by more senior and experienced members of the audit team. The actions included within our overarching findings in respect of resourcing and project management address this specific finding.

Enhance the audit work performed for the valuation of certain pension, property and intangible assets

The valuation of assets can involve significant judgement. Audit teams should apply an appropriate level of challenge to ensure that valuations appropriately reflect the asset’s fair value.
Key findings

We raised a number of issues relating to the evidence of appropriate consideration or challenge of the valuation of pooled investment vehicles (PIV) pension assets and also some issues relating to property valuations and internally generated intangible assets.

In particular, there were recurring findings (on five audits) in relation to the valuation of PIV pension assets (investment funds that use funds from numerous investors). In these cases, the audit team did not undertake an adequate assessment of the nature of the pension assets, including the extent of complexity and judgement required to value the pension assets, and therefore did not adequately identify the higher risk assets. In addition, where audit teams relied on third party service organisation control reports in relation to custodians’ valuation controls as part of their audit procedures, they did not adequately assess the information reported on these controls.

Firm’s actions:

Updated guidance in respect of complex PIV assets was issued to audit teams at the end of 2019 and this reinforced required procedures in areas where findings were noted in the audits subject to inspection. We have received feedback from the FRC on the extent of procedures required to be performed in respect of PIV assets and the sufficiency of available evidence.

We have provided specific pensions training on the review and extraction of information from ISAE 3402 reports, to ensure that our consideration of relevant valuation controls is clearly evidenced.

In respect of the other assets referenced, our RCA has identified specific workpaper enhancements to assist our audit teams in capturing the detail of evidence evaluated and the need for certain additional considerations.

Further improve group audit teams’ direction and supervision of component audit teams

The group audit partner and group audit team are responsible for the oversight of the group audit and therefore need to demonstrate sufficient involvement throughout the audit process, in particular for higher audit risk areas.

Key findings

For all group audits, we reviewed the level of involvement of the group audit partner and other group audit team members in the direction, supervision and review of the component audits. The audit work was usually performed to a good standard. However, on the following audits, improvements were required in respect of the group audit team’s direction and supervision:

• On one audit, the group’s head office and all trading components were based overseas. The UK-based group audit team performed the oversight of the component audits, alongside an overseas PwC member firm. The UK partner and senior staff members did not spend sufficient time visiting the overseas components or make any visits to them after the year-end. In addition, there was insufficient evidence of their review of the component audit files, including on judgemental and complex areas.
• On two other audits, there were specific areas of the audit where there was insufficient evidence that the group audit team had adequately assessed the work of the component auditors.

**Firm’s actions:**

Our work on Group audits has historically been identified as an area of good practice. In this year’s inspection on one audit a number of findings were identified which were particular to that audit’s unique circumstances. As part of our RCA, we identified specific risk factors relating to the ease of application of complex group audit planning methodology to both global groups audits and complex group referred reporting audit engagements (RRAE), and the extent of component working paper review required for audit risks designated as elevated at a group level. In response, our Audit Methodology team is revising policy, guidance and standard work programmes to support our teams executing these activities.

Group RRAEs are inherently complex. In response to the AQR finding, and internal reviews, we are implementing a mandatory first year audit consultation on audit structure and execution plan with Audit Methodology. The Audit Methodology team are also developing further, practical guidance and standard work programmes to assist with the complexities of group RRAEs, including considerations around the balance of time spent physically overseas and performing remote review using technology.

**Good practice**

We identified examples of good practice in the audits we reviewed, including the following:

• **The scoping of audit work on first year audits:** we observed well planned and scoped audit approaches for two first year audits.

• **The use of and interaction with the firm’s internal specialists and experts:** audit teams often use the firm’s specialists (working as part of the audit team) or experts (reporting to the audit team) in areas such as property valuations and tax. Examples of good practice included the involvement of forensic experts in litigation matters and the extent of corroborating evidence obtained where outliers were identified.

• **The quality of the firm’s summaries of audit responses to significant risks and related findings:** audit teams prepare significant matter summaries to provide an overview of the audit responses to significant risks and related findings. The significant matter summaries prepared for most audits we reviewed were of a good standard.

• **The quality of written communications with Audit Committees:** written communications to Audit Committees were often of a good standard, written in a clear and informed manner.
3 Review of firm-wide procedures

We reviewed firm-wide procedures, based on those areas set out in International Standard on Quality Control (UK) 1 (“ISQC1”), as well as certain other key audit initiatives. We review some areas on an annual basis, and others on a three-year rotational basis.

This year, our firm-wide work primarily focused on the following areas:

- Partner and staff matters.
- Acceptance and Continuance (A&C) procedures.
- Audit quality initiatives.
- Root Cause Analysis (RCA) process.

Partner and staff matters

Background

Processes relating to the appraisal and remuneration of partners and staff are a key element of a firm’s overall system of quality control and are integral to supporting and appropriately incentivising audit quality. Our inspection included an evaluation of the firm’s policies and procedures, and their application to a sample of partners and staff for the 2018 appraisal year, across the following areas: appraisals and remuneration; promotions; recruitment; and portfolio and resource management.

Key findings

We identified the following key findings, where the firm needs to improve the consideration of audit quality in relation to:

- Relevant metrics in staff appraisals: the firm does not have a formal process in place to ensure that all relevant quality metrics (including the results of internal or external inspections) are appropriately considered and reflected in senior staff appraisals. For some of the appraisals reviewed, it was unclear how adverse quality findings had been considered.

- The senior staff promotion process: the firm does not have a formal assessment process in place for manager and senior manager promotions, to ensure that audit quality is appropriately and consistently considered for promotions across all business units. Our review of a sample of manager and senior manager promotions included some examples where there was little or no evidence of how audit quality had been considered in the promotion process.
**Good practice**

We identified the following areas of good practice:

- **Consideration of audit quality in partner appraisals:** the forms we reviewed incorporated clear consideration of audit quality, including detailed commentary on the results of internal and external quality inspections in the year.

**Firm’s response and actions:**

Since the inspection performed by the AQR on our performance year processes in Performance Year 2018 (PY18) the global network has implemented a new people management system. Workday was implemented during PY19, with a number of enhancements in respect of people management and performance evaluation.

The firm does not include engagement level quality outcomes, such as inspection results, in staff appraisals, instead ensuring that relevant factors are considered through the oversight of an individual’s career coach and performance evaluation processes. In both PY19 and for PY20 individuals have been required to perform a self-assessment against their own individual and the Audit line of service quality goals. For PY20, ‘the critical few behaviours’ which underpin audit quality will also be required to be considered, and these will be further embedded into our performance evaluation, progression and promotion criteria.

We have implemented the use of standardised promotion templates for manager and senior manager promotions for PY20, ensuring that the consideration of audit quality is more explicit in the promotion process.

**Acceptance and Continuance (A&C) procedures**

**Background**

Audit quality control processes incorporate risk management procedures and are undertaken at various stages of the engagement. In accordance with the requirements of ISQC1, the firm has detailed policies and procedures relating to acceptance and continuance decisions for audited entities. We have reviewed these processes and their application within our firmwide inspection activity this year.

Given the greater number of audit tenders in recent years, we assessed firms’ acceptance and continuance processes as at October 2019. We also discussed with senior leadership any proposed changes to these processes together with each firm’s strategic decisions. In addition, we considered firms’ policies relating to withdrawal/dismissal from audits and, for a sample of audits, the statements provided to the public, successor auditors and the regulatory authority in connection with withdrawal/dismissal.

**Key findings**

We identified the following key finding, where the firm needs to improve the acceptance and continuance (A&C) system in relation to:
• Enabling the A&C system to more fully record and explain the conclusions: the firm has a number of activities and processes which inform its client and engagement acceptance consideration. This includes the A&C form, which is used by engagement teams to capture their conclusions to a set of standard client and engagement risk questions, and escalate approval for higher risk audit engagements to business unit and central risk management.

• The firm’s A&C form focuses on a choice of set responses. There is limited functionality within the current system to enable preparers to justify and explain their responses, including the overall conclusion as to why it is appropriate to accept or continue acting for the entity. The current form does not give sufficient prominence to the assessment of the potential impact on the firm’s brand and reputation risk.

• In addition, the firm’s processes allow the approval of an entity’s A&C form before the completion of all independence and due diligence checks.

**Good practice**

• **Notification of entities that should not be accepted as an audit (“Black box” list):** where the firm concludes that it should not accept or continue work on specific entities (for example, in respect of concerns relating to reputation risk, integrity of management or legal matters), the entity is added to a “black box” list with the relevant reason. This list is maintained centrally and is available to the PwC network.

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**Firm’s response and actions:**

The A&C system is a network-wide record of audit engagement risk designation. The A&C form is used by the engagement team to record its conclusions in respect of entity and engagement risks, and formally to escalate the designation of higher risk audits to the Audit Risk Management Partner. The A&C form highlights where other take-on procedures, such as the independence or Anti-Money Laundering checks, are ongoing at the time of approval.

Whilst we are satisfied that the combination of audit team procedures and wider controls currently manage the existing audit acceptance and/or continuance risk, we recognise certain shortcomings in the granular detail of the A&C form. In FY21, the network is planning updates to the global A&C system and matters identified by the inspection team have been shared as part of this project.

The A&C form is not designed to consider commercial, operational, strategic or portfolio risk. These are other considerations, outside of the individual engagement team’s remit, made at line of service, Business Unit, office, and engagement leader portfolio level by (for example) Business Unit Risk Management Partners, Business Unit Leaders and Audit Leadership. There are no examples where the firm has taken on an audit without due consideration of the entity.

In 2020, as part of the PEAQ programme, the firm implemented an Audit Tender Approval Panel (ATAP). These acceptance panels consider the entity association, commercial, operational, strategic and portfolio risk for all new acceptances.
Audit quality initiatives

Background

We reviewed key aspects of the firm's plan to improve audit quality ("the plan"), including the firm's monitoring of the progress of the plan and other key audit quality initiatives. This included the consideration of recurring themes identified in the RCA of past inspection findings, in the following areas: culture of the firm, including the challenge of management; in-flight reviews (internal reviews undertaken during the audit) and the extent of central support; and project management/milestone programs (monitoring the phases of completion of audits).

PwC started to implement its detailed Programme to Enhance Audit Quality ("PEAQ") during the summer of 2019, to achieve greater consistency in audit quality.

The plan is focused on enhancing audit quality and includes the following initiatives:

- Separation of the audit and risk assurance lines of service and the related governance structure.
- Increased resources.
- Enhanced training.
- Embedding a culture of challenge.
- Increasing the number of in-flight reviews and the extent of central support.

PwC has implemented the plan on a phased basis to ensure it is manageable and achievable. Given when the plan was introduced, it will not have had any impact on the audits we reviewed in this inspection cycle.

The separation of audit and risk assurance lines of service, increased resources, and enhanced training were completed or well progressed by December 2019, so have the potential to improve the quality of audits for our next inspection cycle (2020/21). The other initiatives were less advanced, albeit in line with planned milestones.

Some of these initiatives, for example changing behaviours relating to the challenge of management, will take time to embed fully. We will continue to monitor this in our next inspection cycle.

Key findings

Our key findings are set out below and have been communicated to the audit leadership during the year so that relevant actions could be taken on a timely basis:

- Increase the number and depth of the in-flight reviews: while the firm has other pre-issuance review procedures performed during the audit (such as accounting technical reviews) the level of resources to perform in-flight reviews (which focus on the audit procedures) was behind plan at the end of 2019. In addition, the coverage and depth of the reviews (including FTSE 350 and other listed audits) was below some other similar sized firms.
• Enhance project management procedures, such as through a formal milestone program: one of the key themes from the prior year’s RCA related to ineffective project management on audits. The PEAQ and other planned actions have not adequately addressed this. Some other firms have formal milestone programmes with clear targets for when key phases of the audit should have been completed.

Good practice

We identified the following areas of good practice as part of the plan:

• **Implementing new critical behaviours into the audit practice, including challenge of management:** following a report by Professor Karthik Ramanna on building a culture of challenge, commissioned by the firm, PwC has encouraged certain key behaviours in the audit process, being: challenge and be open to challenge, team first and take pride. A network of “culture champions” was set up in late 2019 to support the communications and roll out within audit.

• **Central support – Chief Auditor Network:** a network of senior auditors (partners, directors and senior managers) was set up in late 2019 to provide methodology support to audit teams and to promote audit quality initiatives. The expectation is that the relevant individuals spend approximately half of their time on this support role.

Firm’s response and actions:

As set out in further detail in our overarching response, the PEAQ includes workstreams and activities identified by Audit leadership together in an overarching audit quality plan. The plan is monitored and reported to multiple levels of leadership on a frequent basis.

Included within this reporting are ‘at risk’ activities which are the focus of the Audit Executive. This includes the HPC programme (in-flight reviews) where focus has been on bringing experienced auditors into the team. Whilst progress to bring the right individuals into the team continues to be slower than originally anticipated, we are continuing to identify and train additional resources such that the number of HPC reviews performed can be increased in FY21. The creation of the Chief Auditor Network also provides ongoing resources to the HPC team. The scope of HPC reviews was expanded during 2019 to include aspects of detailed audit work.

Following our RCA and feedback from the AQR, the PEAQ Supply and Demand workstream now includes an activity stream focused on how teams structure, manage and deliver their audits, and enhancing our audit teams’ project management skills. The aim of the project is to drive earlier completion of key milestones, refocus planning activities to drive greater consistency in the use of the distributed delivery model and technology, and improve project management discipline and training. The phased implementation has started by focusing on planning milestones and is being piloted with selected teams in 2020. All teams will be required to execute on the new planning milestones from 2021.
The firm's RCA process

Background
The RCA process should be designed to identify the causes of inspection findings, in order to aim to prevent them from recurring. It is part of a continuous improvement cycle of inspecting audits, investigating the root causes for inspection results and improving the firms’ ability to act on them through implementing effective actions.

The firm has been performing RCA for several years and follows methodology and guidance issued by the global firm, supplemented by additional UK specific procedures.

This year, we have reviewed the firm’s 2018/19 process for undertaking its RCA, including resources and timing.

Key findings
The firm should further improve the RCA process, in particular in relation to:

- Scope of AQR category 3 inspections: the firm did not perform a full RCA review for AQR category 3 inspections, given it did not carry out certain interviews with audit team members. The firm did not have a formal policy for the scope of these reviews. Extending the scope of this work should improve the effectiveness of the RCA process.

- The timing of the reviews: while the firm has planned to improve the timing of the RCA reviews, unlike some other firms, it does not set formal deadlines for the completion of individual reviews. Undertaking reviews more promptly will help respond more fully to issues.

Good practice
The firm has continued to develop its RCA process. We identified examples of good practice in the RCA process:

- **Focused group sessions:** in addition to interviews with audit teams, the firm holds focused group sessions for specific themes, to help identify the root causes.

- **Use of behavioural specialists:** these specialists have been involved in training and assisting RCA teams to prepare for interviews, as well as designing tools to see how the firm’s critical behaviours were being used by audit teams. They also attended certain focus group sessions.

Firm’s response and actions:
Our RCA process has evolved significantly over the past few years, following input from our global network team and regulatory feedback. In 2019, there were specific reasons for formal interviews not being undertaken with certain engagement leaders, including where the RCA team had already spent extensive time with the engagement leader which led to an understanding of the factors impacting the rating on the engagement.
In February 2020, a structured approach to RCA was approved by the Audit Executive, including a standardisation of activities which will be undertaken in respect of all 3 rated engagements. In 2020, we have piloted an enhanced methodology on the AQR findings, using risk factors derived both from previous RCA performed at PwC and other publicly available information. We will continue to enhance our RCA methodology going forward and are creating a dedicated team specialising in RCA activities across inspection, review and other activities with the objective of performing RCA activities on an ongoing, and therefore more timely, basis.

**Independence – further strengthen the approval process for non-audit services**

**Background**

The timely approval of non-audit services by the audit engagement partner reduces the risk of a non-permissible service commencing on an audited entity.

**Key finding**

As stated in prior years, the firm’s processes do not require audit engagement partner approval before service teams obtain engagement codes to charge their time. The firm is reliant on changes to PwC global systems to address this matter. Additional guidance, training and certain system changes have been implemented in the year, however further enhancements are still needed to strengthen the non-audit service approval process, in line with the extent of procedures at some other firms.

**Firm’s response and actions:**

During 2019, the firm made a voluntary commitment not to provide non-audit services to FTSE 350 audited entities. This commitment was superseded by the Ethical Standard whitelist in March 2020.

Whilst we recognise the matter which the inspection team continue to raise, as non-audit services have historically been undertaken for global clients by PwC firms across the network, a specific automated control cannot be implemented without network wide finance system changes. We continue to improve the control environment around non-audit service restrictions and the approval processes, monitor the level of FRC Ethical Standard and other regulatory breaches, and provide training and Ethical Standard resources to our teams.

As part of improving the non-audit service control environment during 2019, amendments were made to our Client Record Management system to embed the automated generation of an Authorisation for Service (AFS) approval request for non-audit service delivery to the audit engagement leader. This was supported by enhancements to our policy and mandatory training. Furthermore, we are currently piloting a manual AFS approval to engagement specific finance code generation in one line of service, with a view to rolling this out during 2021 should it be successful.
Appendix 1: Firm’s internal quality monitoring and ICAEW results

This appendix sets out information relating to the firm’s internal quality monitoring for individual audit engagements. It should be read in conjunction with the firm’s transparency report for 2019, which provides further detail of the firm’s internal quality monitoring approach and results, and the firm’s wider system of quality control. We consider that publication of these results provides a fuller understanding of quality monitoring in addition to our regulatory inspections, but we have not verified the accuracy or appropriateness of these results.

Due to differences in how inspections are performed and rated, the results of the firm’s internal quality monitoring may differ from those of external regulatory inspections and should not be treated as being directly comparable to the results of other firms.

Results of internal quality monitoring

The results of the firm’s most recent Engagement Compliance Review (“ECR”), which comprised internal inspections of 142 individual audits, the majority with periods ending between 31 March 2018 and 31 December 2018, are set out below along with the results for the previous two years.

<table>
<thead>
<tr>
<th>Year</th>
<th>Non-compliant</th>
<th>Compliant with review matters</th>
<th>Compliant</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>2%</td>
<td>14%</td>
<td>84%</td>
</tr>
<tr>
<td>2018</td>
<td>7%</td>
<td>4%</td>
<td>89%</td>
</tr>
<tr>
<td>2017</td>
<td>6%</td>
<td>4%</td>
<td>90%</td>
</tr>
</tbody>
</table>
An engagement is graded as:

- Compliant – when relevant auditing, assurance, accounting and professional standards have been complied with in all material respects;

- Compliant with Review Matters (CwRM) – when the issues identified for improvement (in either substantive or controls work) are mitigated by additional or alternative audit procedures which had been performed in the audit, the departure from accounting standards is not considered to be significant, or where there are opinion issues that are more than grammatical/punctuation errors but which do not mislead the user; or

- Non-Compliant (NC) – when relevant auditing, assurance accounting and professional standards or documentation requirements were not complied with in respect of a material matter.

**Firm’s approach to internal quality monitoring**

The firm’s ECR program considers the full population of audits performed and is designed to cover both the firm’s responsible individuals (“RIs”) and specific categories of audit clients. The ECR program involves a post-signing review of an audit engagement for each RI at least once every three years, and twice in any six-year period for audits identified by the firm as having a high public profile. ECRs are led by experienced partners and are supported by teams of partners, directors and senior managers who are independent of the audit under review. The outcome of each review is evaluated using a standard set of principles set by the PwC Global Network to assess whether relevant auditing, accounting and professional standards have been complied with. A moderation panel, composed of the review team, the firm’s UK Quality Review Leader and a member of the Firm’s Global Inspections team, forms an overall engagement assessment considering the nature and severity of the individual findings in each review.

The firm undertakes root cause analysis (“RCA”) for all inspections with Non-Compliant outcomes and a number of Compliant with Review Matters and Compliant engagements, including engagements identified as ‘best in class’. The best in class analysis helps identify success factors that inform potential actions. Following RCA, a Quality Improvement Plan (“QiP”) is developed to respond to the drivers of systemic issues and specific matters arising from the ECR. Responsive actions may be identified at either the engagement delivery and/or line of service levels. Completion of the ECR and Regulatory finding action plans are monitored by the Audit Risk and Quality leadership, the Audit Executive and the firm’s Public Interest Body.

**Firm’s response and actions:**

The 2019 ECR results reported a small reduction in the percentage of engagements graded compliant (2019: 119 audits, 2018: 121 audits), and an increase in the percentage graded CwRM (2019: 20, 2018: 5). The specific factors driving Non-Compliant (2019: 3 audits, 2018: 10 audits) and CwRM audits included:

- Errors or omissions in the auditors’ report that were not considered to mislead the end user of the financial statements;
• The sufficiency of audit evidence to support challenge of key assumptions relating to certain management estimates;

• The extent of component auditor procedures specifically relating to the supporting financial information provided to the group auditor as part of inter-office reporting; and

• The incorrect application of PwC audit methodology to journal entry testing and certain cash audit procedures.

The ECR checklist is broad, including questions relating to compliance, application of PwC audit policy and auditor judgements. With the exception of the high public profile entity rotation requirements, audits subject to ECR are not risk targeted but are aimed at achieving coverage across all engagement leaders. The difference between the ECR and AQR grading profiles is due to a much larger sample size in the ECR, risk profiling by the AQR in their sample, and the different scope of each review process. We note that the overall trend in results year on year is similar for both the ECR and AQR reviews.

Our RCA procedures covered both engagements with specific review findings and those designated as best in class, to identify key factors which impact the quality of audit delivery. From this, we determined our best in class audits have:

• An optimal engagement team which includes auditors with good audit technical knowledge and softer auditor skills, such as coaching and team management. Continuity of team members within an engagement team is also an important factor;

• A team with a strong common focus, led by the Responsible Individual, results in more consistent high quality audit delivery. This is also enhanced by strong engagement with Quality Review Partners; and

• Management at the organisations we audit who provide better quality financial information and audit evidence, and are more open to auditor challenges. Engaged management also helps facilitate more effective project, timeline and deadline management by the engagement team.

Within the small sample of audits which were graded Non-Compliant or CwRM, we identified aspects of these factors which were suboptimal or not present. We also identified instances: where the extent of coaching and supervision of overseas secondees or externally recruited experienced auditors did not sufficiently address integration challenges including the application of PwC audit methodology; and weaknesses in review procedures performed by audit managers which did not identify omissions or errors in detailed audit working papers, due to either a lack of capacity and/or attention to detail.

In addition to a number of specific changes to work programmes, the issuance of additional guidance and topic-specific auditor training, a number of the causal factors identified from the ECR RCA were incorporated into the Programme to Enhance Audit Quality (PEAQ) and are addressed by the programme's workstreams and individual projects, such as additional recruitment and enhanced onboarding procedures.
Results of ICAEW monitoring

Background

The firm is subject to annual independent monitoring by ICAEW. ICAEW undertakes its reviews under delegation from the FRC as the Competent Authority. ICAEW reviews audits outside the FRC’s population of retained audits, and accordingly its work covers private companies, smaller AIM listed companies, charities and pension schemes. ICAEW does not undertake work on the firm’s firm-wide controls as it places reliance on the work performed by the FRC.

Scope

Reviews of audits are either standard-scope or focused. Standard-scope reviews are designed to form an overall view of the quality of the audit. ICAEW assesses the audits it reviews as either ‘satisfactory / acceptable’, ‘improvement required’ or ‘significant improvement required’. Where appropriate, ICAEW also carries out focused reviews to follow up on significant issues highlighted in the previous year’s file reviews or other specific risks. These reviews are limited in scope. Visit icaew.com/auditguidance for further information about ICAEW’s audit monitoring process including its approach to assessing audits.

ICAEW has completed its 2019 monitoring review and the report summarising its audit file review findings and any follow-up action proposed by the firm will be considered by ICAEW’s audit registration committee in September 2020.

Results

In 2019, seven of the ten standard-scope reviews were satisfactory/acceptable, with two requiring improvement and one requiring significant improvement. ICAEW also carried out two focused reviews and did not identify any issues.

The results of these reviews indicate that while most of the firm’s audit work reviewed continues to be of a good standard, there are issues on some audits that need to be addressed.

• The audit of a contracting business needed significant improvement, specifically in the combination of controls and substantive testing on particular contracts.

• In two other audits the file documentation did not demonstrate appropriate challenge of management in relation to key audit judgements. These judgements related to a change in accounting policy and revaluation of tangible fixed assets, and intangible fixed asset impairment.

Other findings related mainly to isolated aspects of audit evidence and documentation, with no particular themes. ICAEW identified and shared a number of examples of good practice.
Response from the firm

As with the AQR’s 2019/20 inspection, we are disappointed with the outcome of the 2019 ICAEW monitoring review. The specific findings identified in the three audits requiring improvement are consistent with the nature of matters identified in the AQR’s inspection of the firm. The QAD’s findings have been incorporated into our root cause analysis and actions designed in particular in response to the key findings on challenge of management assumptions and long term contract audits. The actions set out in our overall response to the report, including the work streams and activities within the Programme to Enhance Audit Quality, are expected to deliver consistently high quality audits.