Financial Reporting Council

Tier 1 Firms – Overview

Audit Quality Inspection and Supervision Report

July 2023

Contents

Appendices

1. Overview

Overall audit quality continues to improve at the largest audit firms based on the results of our individual audit quality inspections.

Of the audits inspected, 77% were categorised as good or limited improvements required (2021/22: 75%). Over the last four years we have seen a 10% increase in this key measure of audit quality (2019/20: 67%).

We reviewed 100 individual audits (2021/22: 96) across the seven Tier 1[1], firms this year. Six of the seven firms have improved or maintained their audit quality results, with at least the same percentage of inspections requiring no more than limited improvements. It is particularly encouraging that five of the firms had no audits requiring significant improvements, with the number of audits requiring significant improvement having reduced to 3% (2021/22: 7%).

The FTSE 100 audits are often the most complex entities and, of the 16 audits inspected, none were identified as requiring significant improvements. The percentage requiring no more than limited improvements was 81%, which is higher than the 77% across all audits. Of the 27 FTSE 250 audits we reviewed this year, we assessed 22 (82%) as achieving this standard.

Following a re-evaluation of all firms that fall within the scope of our supervision, we have re-allocated several firms within our tier system. This includes Grant Thornton UK LLP who, effective May 2023, are now included within Tier 2. Further details, together with the implications of this change for figures included above, are set out in Appendix 7.

77%

Overall, an increasing number of audits inspected were categorised as good or limited improvement required.

[1] The seven Tier 1 firms in 2022/23 were: BDO LLP, Deloitte LLP, Ernst & Young LLP, Grant Thornton UK LLP, KPMG LLP, Mazars LLP, PricewaterhouseCoopers LLP. We have published a separate report for each of these seven firms along with a cross-firm overview report.

Our forward-looking supervision work is risk focused and proportionate. We hold the firms to account to drive improvements in audit quality.

There has been a 10% increase in audits categorised as good or limited improvements over the last four years. However, we continue to identify inconsistency in application of methodology and guidance. It is important that the firms' actions are robust and comprehensive with effective monitoring to ensure we can accelerate quality improvements further.

The FRC plays a key role in the audit market, serving the public interest to improve audit quality and enhance trust in audit. Our forward-looking supervisory approach focuses on fair and proportionate regulation using a balanced but assertive approach – holding the firms to account to make those changes needed to safeguard and improve audit quality – whilst acting as an improvements regulator to drive further enhancements.

In 2023/24, we will:

- **Continue risk-based supervision:** On those firms that have the largest share of the UK Public Interest Entity (PIE[2]) audit and Major Local Audit (MLA) market, and thus where weaknesses in the firm would have the greatest impact on overall audit quality.
- **Targeted activity:** Reduce inspection and supervision activity at firms where we have seen sufficient and sustained improvements in audit quality. This enables us to invest resources elsewhere, including at firms where audit quality improvements have been insufficient.
- **Share good practice:** We are an improvements regulator and have established various initiatives to support firms, including sharing good practice and outlining our expectations of what good looks like.
- **Continue our focus on culture initiatives:** Perform an ongoing assessment of audit firms' cultures with a specific focus on the firms' own culture assessment and encouraging a speak up culture. We will also be undertaking a survey across all Tier 1 firms to provide further evidence and cross-firm benchmarking of elements of audit firm culture that promote high quality audit.
- **Develop our engagement with Audit Committee chairs:** Increasing our outreach and transparency, enabling appropriate involvement by those charged with governance in audit quality.

Our forward-looking supervisory approach focuses on fair and proportionate regulation using a balanced but assertive approach.

[2] Public Interest Entity – in the UK, PIEs are defined in Section 494A of the Companies Act 2006 and in Regulation 2 of The Statutory Auditors and Third Country Auditors Regulations 2016.

- **Respond to emerging issues:** The audit market is continually evolving and the risks for audit firms responds and adapts to emerging issues globally. The FRC has direct engagement with relevant stakeholders to respond effectively to emerging and evolving concerns in areas affecting quality, conduct and resilience. This responsive approach will continue throughout 2023/24, so we can support and enhance trust in audit.
- **Continue to assess and evaluate the effectiveness of our reporting:** To ensure continual improvements and transparency of the outcome of our supervisory activities, including a consideration of the impact of relevant aspects of ISQM (UK) 1[3] on the timing and extent of our public reporting.

The FRC continues its strategy for taking the organisation through a period of significant change pending the creation of the Audit, Reporting and Governance Authority (ARGA). Once ARGA is formed this will provide us with additional statutory powers.

Further details of our forward looking supervision approach are set out in Appendix 6 and in [Our Approach to Audit Supervision](#).

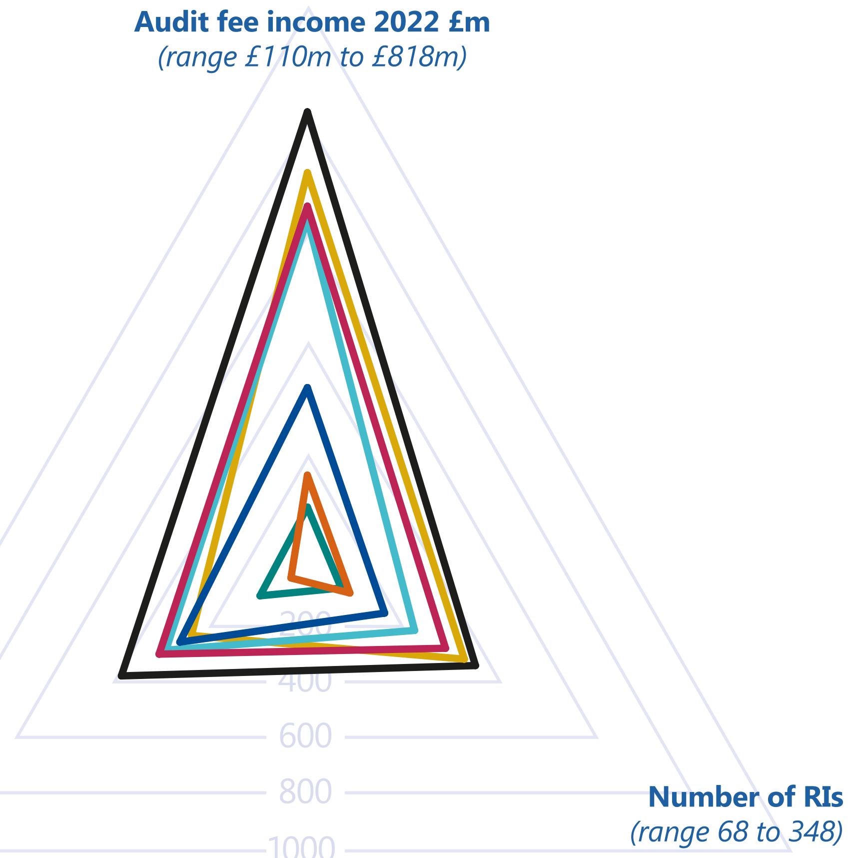
[3] International Standard on Quality Management (UK) 1

Relative size per firm

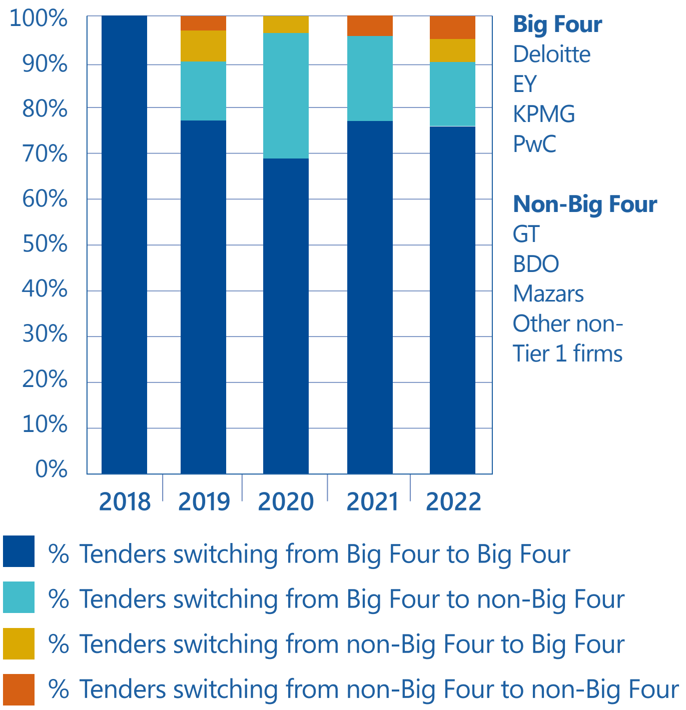
Audit fee income	BDO	Deloitte	EY	GT
2022 £m[1]	324	649	626	167.1
Number of RIs[2]	160	286	222	88
Audits in scope[3]	264	307	293	34

Audit fee income	KPMG	Mazars	PwC
2022 £m[1]	709	110	818
Number of RIs[2]	325	68	348
Audits in scope[3]	240	98	385

[1] **Source:** the FRC's 2020, 2021 and 2022 editions of Key Facts and Trends in the Accountancy Profession.
[2] **Source:** the ICAEW's 2023 QAD report on the firms.
[3] **Source:** the FRC's analysis of the firm's PIE audits and other audits included within AQR scope as of 31/12/22.



Auditor switching
in the FTSE 350 2018-2022

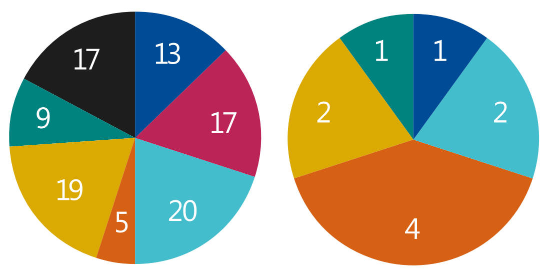


Source: Auditor data from Audit Analytics' Auditor Changes Database; FTSE 350 constituents as at 30 April 2023.

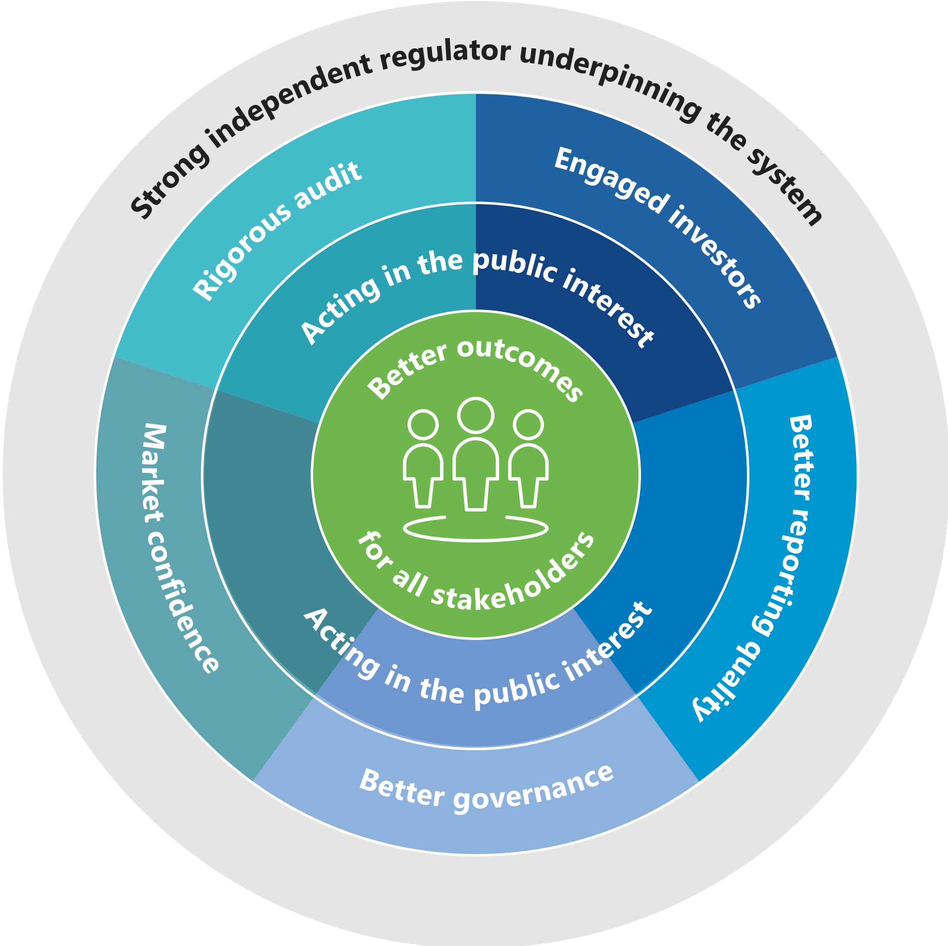
Corporate audits inspected

MLAs* inspected

*Major local audit



Corporate audits inspected		MLAs inspected	
13	BDO	1	BDO
17	Deloitte	0	Deloitte
20	EY	2	EY
5	GT	4	GT
19	KPMG	2	KPMG
9	Mazars	1	Mazars
17	PwC	0	PwC
100	**Total**	**10**	**Total**



Our supervisory approach

The audit supervisory teams in the FRC's Supervision Division work closely together to develop an overall view of the key issues for each firm to improve audit quality. We also collaborate to develop our plans for future supervision work.

The supervisory staff producing our reports

90

The audit supervisory teams comprise 90 experienced professional and support staff assessing the risks to audit quality and resilience at each firm and the actions needed to address those risks.

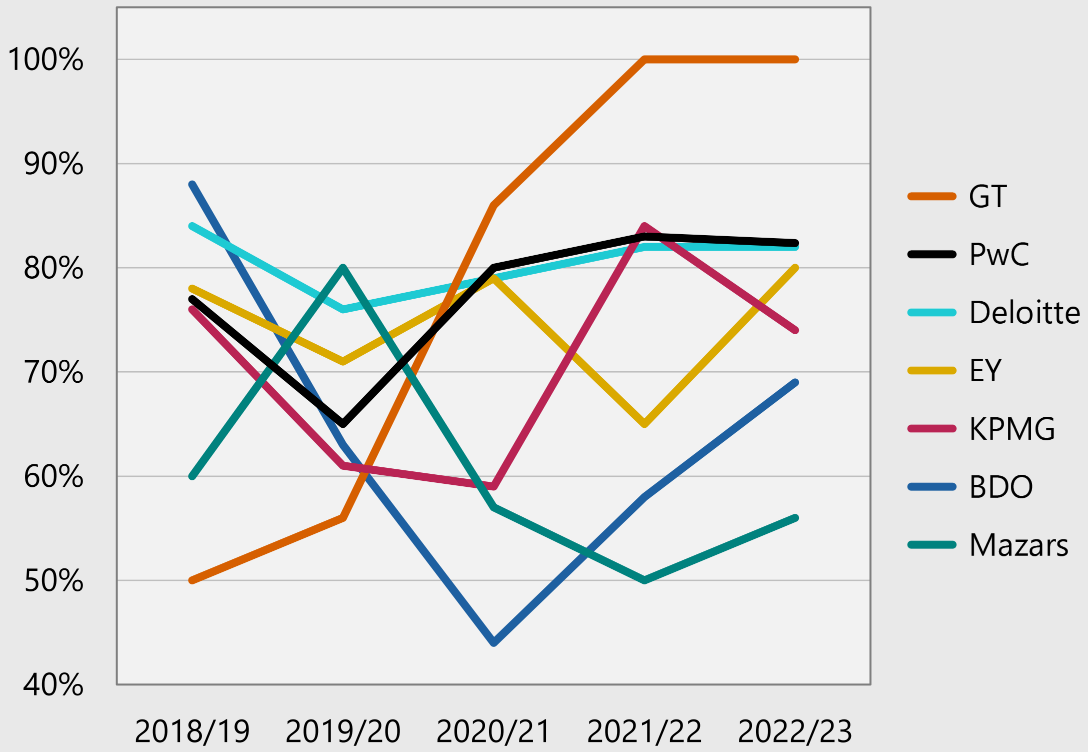
What is high audit quality?

The FRC defines high quality audits as those that:

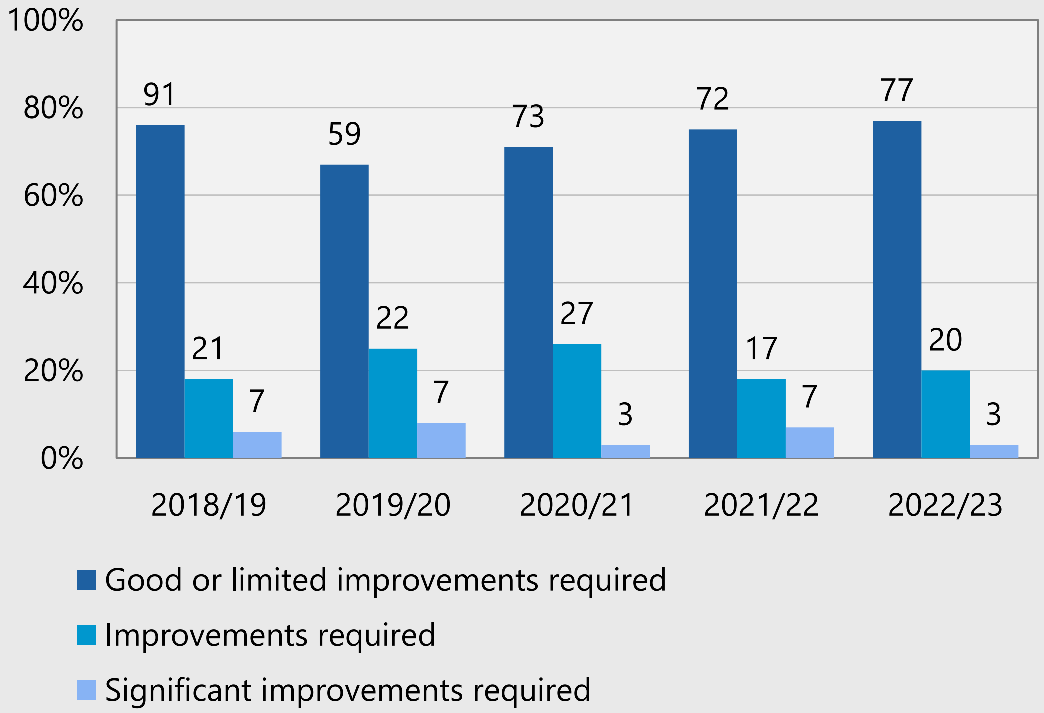
- Provide investors and other stakeholders with a high-level of assurance that financial statements give a true and fair view.
- Comply both with the spirit and the letter of auditing and ethical standards and applicable legal and regulatory requirements.
- Are driven by a robust risk assessment, informed by a thorough understanding of the entity and its environment.
- Are supported by rigorous due process and audit evidence, avoid conflicts of interest, have strong audit quality processes, and involve the robust exercise of judgement and professional scepticism.
- Challenge management effectively and obtain sufficient audit evidence for the conclusions reached.
- Report unambiguously the auditor's conclusion on the financial statements.

Inspection results: arising from our review of individual audits

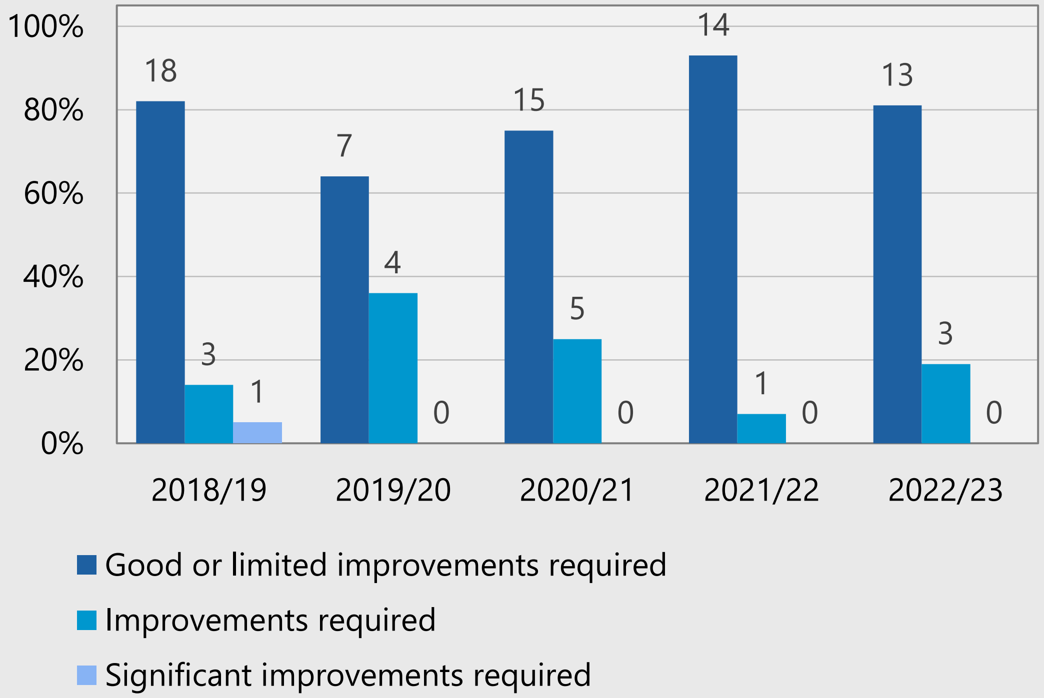
All inspections – Tier 1 (7 firms) – percentage assessed as good or limited improvements required



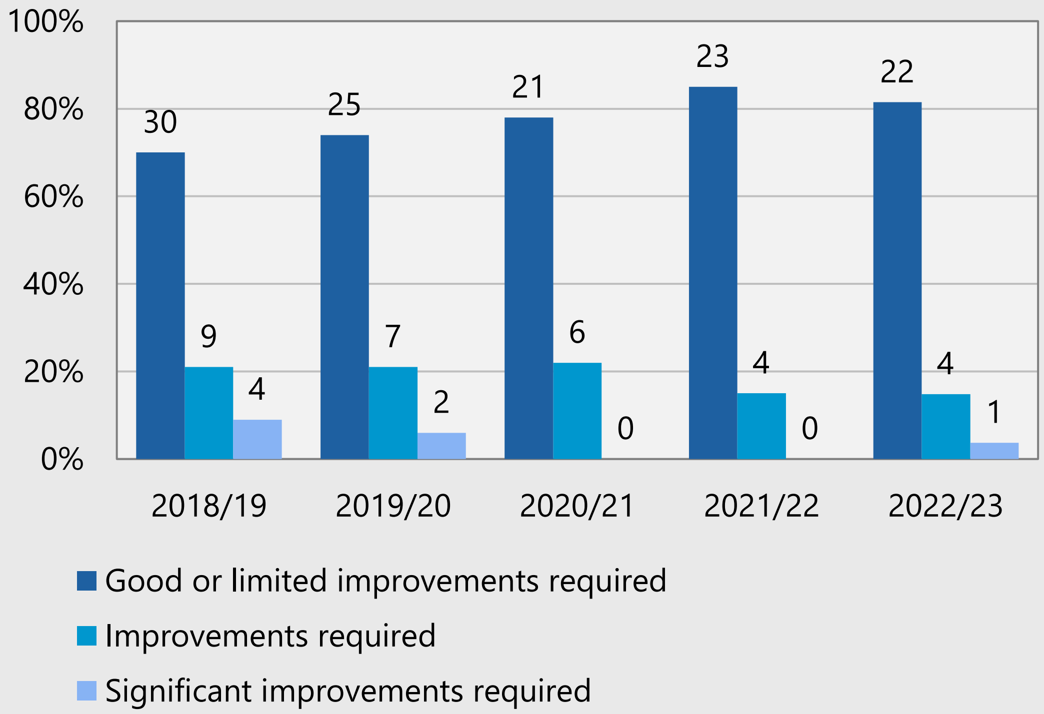
All inspections – Tier 1 (7 firms)



All reviews – FTSE 100



All reviews – FTSE 250



The audits inspected in the 2022/23 cycle included above had year ends ranging from June 2021 to June 2022. We do not select audits for inspection on a statistical basis, instead using a risk-based approach. Changes from one year to the next cannot, on their own, be relied upon to provide a complete picture of a firm's performance and are not necessarily indicative of any overall change in audit quality.

Inconsistency in execution continues to hamper the extent of improvements in audit quality, particularly in areas of estimation and judgement.

The extent of improvement continues to be hampered by inconsistency and recurring findings in the execution of audits. All firms continue to invest in developing their audit systems, methodology and guidance, and providing training, ensuring this is comprehensive and in line with ISA requirements. Our inspections, and those undertaken by the firms as part of their internal quality monitoring, highlight inconsistencies in the:

- Application of methodology and guidance.
- Level of challenge of management.
- Degree of evidence to support and corroborate findings.
- Capacity and capability of resources.
- Effectiveness of review procedures.

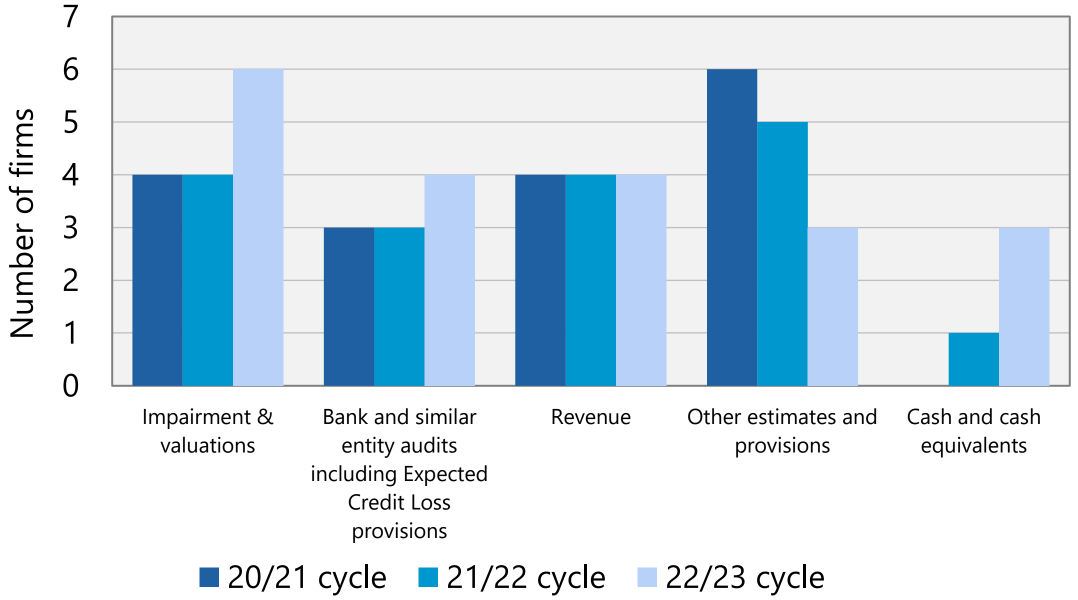
The analysis of common inspection findings and good practice below shows that there has been a high degree of recurring findings and good practice in the same areas over the last three years. For example, while findings have been raised on revenue across four firms, in each of the last three cycles, we have equally identified good practice in this area, illustrating inconsistencies on the audits undertaken overall and by certain firms.

Most of the recurring findings relate to the auditor's evaluation and challenge of management's estimates and judgements, which remain areas of focus on our inspections. At the same time, the robust challenge of management judgements has been the most common area of good practice identified on inspections. It is imperative that audit teams improve the consistency in evaluating management's judgements, and in challenging and corroborating them. As set out in our 2021 publication "What Makes a Good Audit?", professional scepticism and challenge of management is a key behaviour of an auditor and lies at the heart of the values and cultural initiatives of the Tier 1 firms.

Six of the firms have recurring findings in at least one area, and they continue to seek to address this through root cause analysis and refining their actions accordingly. More must be done to understand why previous actions have not sufficiently remediated inspection findings. It is equally important that the remedial actions are sustained to address matters in the long term.

Inconsistency in execution continues to hamper the extent of improvements in audit quality.

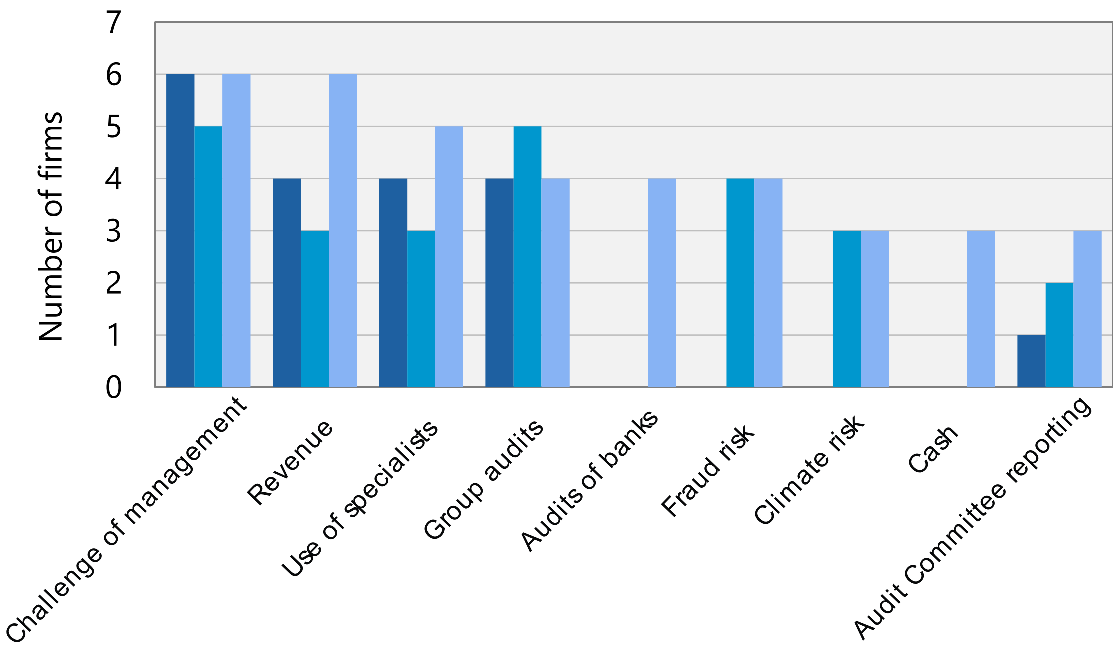
Common inspection findings



Further details of these common findings, along with comments on areas of focus in the 2022-23 inspection cycle, are set out in Appendix 2.

During 2022-23 the most common good practices, based on the number of firms where these observations were raised, were as follows:

Common good practices on inspections



These represent examples of good practice on individual inspections. Further details of these good practices and examples of what good looks like, are set out in Appendix 4.

Findings and good practice examples arising from our review of the Tier 1 firms' quality control procedures are set out in Appendix 3 and 4 respectively.

The overall results from other measures of audit quality, covering a broader population of audits, also show an improvement.

Results of the Quality Assurance Department of the ICAEW

The Quality Assurance Department of the ICAEW (QAD) reviewed 60 individual audits across the Tier 1 firms this year, weighted toward higher risk and complex audits of non-PIE entities within ICAEW scope. The results showed 95% of reviews carried out at the six firms visited by the ICAEW this year were graded good or generally acceptable. Further details are set out in Appendix 5.

Firms' internal quality monitoring review results

The firms also carry out their own internal quality monitoring reviews covering both PIE and non-PIE audits. This information can be seen for each Tier 1 firm in its individual report. Due to the firm's individual approaches and systems of grading, the results across the firms have not been consolidated in this report. Overall, these results are consistent with the FRC inspection results.

All firms continue to be committed to invest in audit quality to evolve their audit practices and respond to emerging issues.

All firms continue to be committed to invest in audit quality to evolve their audit practices and respond to emerging issues.

Each firm has developed a Single Quality Plan (SQP) which identifies priorities to drive measurable improvements in audit quality and resilience. The Firm's leadership must monitor these priorities and measure the effectiveness of actions taken. Priorities vary across the firms. However, we are pleased that firms have continued to invest in audit quality improvements and embed these changes across their audit practice.

Examples of firms' continued investment and improvement in audit quality include:

- **Resourcing:** The profession is facing resourcing difficulties, resulting in a limited and competitive market. Attrition has fallen across all firms during the year, but resource constraints still exist. To respond, firms have developed alternative solutions such as offshore delivery centres, virtual secondments and reassessment of their recruitment strategies to attract a broader demographic and exploring other non-traditional routes of entry.
- **Technology:** All firms continue to invest in technology such as new audit systems, automated tools and techniques and are looking to the future of audit, developing machine learning tools and considering alternative

procedures, in various areas of the audit, to respond to market changes and technological advances. The use of automated tools and techniques can provide robust evidence to support judgemental areas of an audit and the considered use of machine learning has the potential to become part of business as usual. Continued investment in this area is important to ensure that the audit of the future continues to meet the needs and expectations of stakeholders.

- **Culture:** Audit firms need the right culture to drive the behaviours necessary to deliver high quality audits. Differences in mindset and behaviour are often identified as reasons for both positive and poorer inspection results. Firms are continuing to invest in programmes and initiatives to embed a strong message of specific behaviours to promote high standards and trust in the profession.

Inspection results at BDO and Mazars continue to be below their peers.

Following unacceptable inspection results in 2021/22, we further increased the number of audits selected for review at each firm. This year, 69% of the audits that we reviewed at BDO and 56% of the audits that we reviewed at Mazars needed no more than limited improvements. Whilst this is an improvement on the prior year, including a reduction in the number of audits requiring significant improvements, these results still fall below those of their peers.

The results illustrate significant inconsistencies and shortcomings in audit quality at both firms, emphasising the importance for each firm's RCA and related quality action plans to be effective and embedded urgently.

At BDO, the level of recurring findings is unacceptable. All five key findings identified in the current year have recurred from the previous inspection cycles, with four of those findings having recurred for three years. The firm needs to continue incorporating the most frequent and significant recurring findings into their hot and cold review process and also take action to ensure detailed training and guidance continues to be given to the audit practice.

At Mazars, our inspections also identified repeat findings from previous inspection cycles and the lack of improvement is unacceptable. RCA and the subsequent identification of remediation action is a powerful tool to encourage improvement and consideration should be given to where remediation action has proven insufficient or ineffective.

Inspection results at BDO and Mazars continue to be below their peers.

We have seen improvement at both firms in the number of audits assessed as good or requiring limited improvement and in the reduced number of audits assessed as significant improvements required. We also recognise the following mitigating factors in assessing the extent and rate of improvement at both firms

- Timing delays arise between our inspection activity and being able to see the impact of these changes.
- Both firms have responded positively to the FRC's increased level of supervisory activities introduced in 2022, investing in resources, culture initiatives and quality control measures. They have demonstrated a commitment to strengthening their audit quality initiatives, focusing on specific aspects to control growth and improve the quality of future audits. Embedding these initiatives in a sufficiently timely manner is critical to make the required step change in audit quality.
- Both firms have both made good progress in implementing their Single Quality Plan (SQP). This incorporates the priorities of each firm's quality improvement plan and will remain a focus for the year ahead. The SQP should be designed to drive measurable improvements in audit quality and resilience, and both firms must keep under review the prioritisation of actions. Both firms must develop their approach to evaluating the effectiveness of actions taken and progress of these, with appropriate timely monitoring by the firms' leadership.
- Good progress has been made on the actions set out in the previous year's reports. In particular, both firms have strengthened their procedures surrounding acceptance and continuance to ensure that this process is sufficiently robust and supports informed decision making regarding prospective engagements. Mazars must focus on making improvements to the firm's ethics function in response to our concerns relating to its strength and capacity.

It is vital that the firms' leadership appropriately monitors the effectiveness of their actions regularly, during the coming year, to assess their efficacy and to make appropriate decisions to improve quality to the level of their peers.

The FRC will maintain its increased level of supervision at both firms and require them to continue to take action, which will include:

- Maintaining the elevated number of audits inspected in our 2023/24 inspection cycle.
- Assessing the transformation programmes at both firms, tailoring our approach to specific areas of continued concern and risk and the firms' monitoring and effectiveness of implementation of these actions.

- Continued engagement and assessment of the effectiveness of the RCA process in reducing recurring findings and inconsistencies between audit teams.

Firms have a responsibility to consider the impact on the public interest before resigning, deciding not to re-tender and declining an invitation to tender for an audit. The new Audit Firm Governance Code sets out an objective that "firms take account of the public interest in their decision-making, particularly in audit". De-risking audit portfolios may result in audits being undertaken by firms less capable of performing a high quality audit of that entity.

It is not in the public interest for firms to resign from audits without careful consideration of the implications on the public interest and the need for consistent, high quality audit. All entities, regardless of risk, must be audited by audit firms with appropriate resources and robust quality control procedures to deliver a high quality audit.

Over recent years, several Tier 1 firms have been reviewing their audit portfolios, exiting audits solely for commercial reasons or to avoid complex or difficult audits which by definition are harder to audit to a high quality standard and, if not undertaken appropriately, are perceived to have an increased likelihood of an external inspection identifying weaknesses in that audit.

We continue to see examples of de-risking decisions at certain Tier 1 and Tier 2 firms. Consequently, several complex, hard to audit public interest entities have been transferred to smaller firms. Some of these smaller firms may not have the experience, resources or capabilities to perform a high quality audit of these entities. In some cases, as set out in our Tier 2 and Tier 3 inspection and supervision report, these firms have a poorer track record of conducting high quality audits based on external inspection results.

We will be concerned in situations in which the firms that are the most competent and capable to undertake an audit either resign, do not re-tender or decline an invitation to tender with no consideration of the public interest implications.

An audit firm resigning from a challenging company[4] due to weaknesses of management or governance concerns, a breakdown of relationships or where an entity refuses to pay a fair price for a high quality audit would not be classified as de-risking. Firms must, however, have sought to address and resolve concerns through all available mechanisms prior to resigning.

[4] "A challenging company is as seen from the auditor's perspective and may include growing and immature companies as well as simply poorly governed companies with ineffective processes and controls." (The Spring Report – A combined perspective on enhancing audit quality, June 2023).

It is not in the public interest for firms to resign from audits without careful consideration of the implications on the public interest and the need for consistent, high quality audit.

We have seen some good practice in this regard, which illustrates strong commitment to the public interest.

Some firms have introduced early warning mechanisms, highlighting matters that need resolving directly to those charged with governance and management. The firms have then worked with the entity outlining clear expectations on how to address them.

Transparent communications with incoming auditors is critical. Where matters have not been sufficiently progressed or addressed and, as a result, resigning is the only remaining option, some firms have provided complete and transparent information of these matters to the incoming auditor. We have seen examples of clear and comprehensive resignation letters, which set out the risks and concerns arising, where these are relevant to the auditor's resignation. This transparency is useful for all stakeholders.

Prior to continuing or accepting appointment as auditor, firms must follow suitable procedures to determine whether:

- They are competent to undertake the audit.
- They have sufficient and appropriate resources to perform the audit.
- They can comply with the relevant ethical requirements.
- They have appropriately assessed the risk associated with the entity to conclude it is appropriate to accept or continue to act as auditor.

The importance of robust quality control procedures to support acceptance and continuance decisions is key for all audit firms to ensure that all audits, particularly those that are higher risk and more complex, are delivered at the required level of quality and in line with the expectations of its stakeholders.

Management of audited entities and their audit committees are also a critical element of a high quality audit and financial reporting ecosystem.

We acknowledge that, whilst the firms must continue to improve the quality of their audits, other participants in the financial reporting ecosystem have a role to play. For example, a well-governed company, transparent reporting and effective internal controls all help underpin a high quality audit. Management of audited entities and their audit committees must ensure information provided to the auditors is high quality and timely. A responsive and high quality audit plan requires joint execution by management, those charged with governance and the auditor. Across the Tier 1 firms, the quality and timeliness of management information is considered as part of the root cause analysis undertaken when findings arise on an audit inspection.

We have recently published Audit Committees and the External Audit: Minimum Standard. This Standard is directly applicable to Audit Committees of companies included within the FTSE 350 index. It should be read in conjunction with the UK Corporate Governance Code and the FRC Guidance on Audit Committees. Companies within scope are encouraged to begin to apply the Standard as soon as possible. This will be a positive step forward in promoting the importance of audit committee focus on the appointment and oversight of auditors.

The following areas for audit committee and other stakeholders to focus on have been further developed from those included in last year's report. They apply equally to all audit committees, not just of FTSE 350 entities, and will enhance audit quality if performed effectively:

What can audit committees and other stakeholders in the ecosystem do to improve audit quality?

1. Setting the tone for open and robust challenge: The audit committee must lead and govern a healthy and productive culture, instilling strong challenging mindsets and behaviours, to support the delivery of high quality audits that serve the public interest.

2. Audit committees must challenge management and oversee the timely delivery of high quality information to the auditors.

3. Where the auditor highlights weaknesses, relating to areas such as the quality of management information, conduct of management or an insufficient control environment, the audit committee must hold management to account to ensure timely appropriate remedial action. Regular monitoring and challenge of actions must be performed.

4. Audit committees must actively engage with their external auditor throughout the audit process. Audit committees must consider and challenge, where appropriate: the risk assessment, key areas of judgement and the approach taken to respond to the identified risks.

5. A constructive feedback loop is important: Audit committees must seek feedback from the external auditor on their interactions with senior management and the finance team, responding to concerns raised.

6. Audit committee involvement in FRC Audit Quality Reviews: Audit committee chairs must continue to engage with the FRC in respect of audit inspections and evaluating and responding to the audit inspection report, to challenge and support the external auditor's plans to improve audit quality where necessary. In response to a

request from Audit Committee Chairs through Project Spring[5], the FRC has agreed to pilot engagement with Audit Committee Chairs earlier in the inspection process, prior to finalising the inspection report, to explain the findings arising. This will enable Audit Committees to engage with their external auditors from a more informed position and increase transparency of the inspection process.

7. Tender activity considerations: Advanced notification and discussions with potential auditors must be held prior to the announcement of a tender so as not to preclude firms from participating for independence reasons.

8. Execute a robust and challenging tendering process, considering all aspects of the approach to ensure this is fit for purpose and has been tailored to the needs of the entity. The audit committee must discuss the firm's internal quality control procedures to understand how this supports the audit team and a high quality output and review the FRC's audit quality inspection and supervision reports for the relevant firms to obtain an overview of recent findings and good practices identified. The committee must challenge and assess the resource and capability of all auditors in the tendering process to deliver a high quality audit, recognising the specific needs of the entity.

[5] A joint project between the Audit Committee Chairs Independent Forum, the Tier 1 audit firms and the FRC to further enhance audit quality (**Summary** and **Full Report**).

Appendix 1

Introduction: FRC's objective of enhancing audit quality

The FRC is the Competent Authority for UK statutory audit, responsible for the regulation of UK statutory auditors and audit firms. We assess, via a fair evidence-based approach, whether firms are enhancing audit quality and are resilient. We adopt a forward-looking supervisory model and hold firms to account for changes needed to improve audit quality.

Auditors' opinions on financial statements play a vital role upholding trust and integrity in business. The FRC's objective is to achieve consistent high quality audits so that users have confidence in financial statements. To support this, we:

- Set ethical, auditing and assurance standards and guidance, as well as influence the development of global standards.
- Inspect the quality of audits performed by, and the systems of quality management of, firms that audit Public Interest Entities (PIEs[6]) and register auditors who carry out PIE audit work.
- Set eligibility criteria for auditors and oversee delegated regulatory tasks carried out by professional bodies such as qualification and the monitoring of non-PI audits.
- Bring enforcement action against auditors for breaches of relevant requirements.

Since our July 2022 report we have delivered on a reform programme ahead of the Government response to restoring trust in audit and corporate governance, including:

- Taking responsibility for PIE auditor registration allowing us to impose conditions, suspensions and, in the most serious cases, remove registration of PIE auditors.
- Agreeing a memorandum of understanding with the Department for Levelling Up, Housing and Communities (DLUHC) setting out our responsibilities as shadow system leader for local audit.
- Updating Our Approach to Audit Supervision, outlining the work of our supervision teams.
- Publishing a Minimum Standard for Audit Committees and the External Audit and consulting on revisions to the UK Corporate Governance Code.

Our 2023/24 transformation programme will demonstrate our continued commitment to the public interest and restoring trust in the audit profession.

The seven Tier 1 firm reports provide an overview of key messages from our supervision and inspection work during the year ended 31 March 2023 (2022/23) and the firms' responses to our findings.

[6] Public Interest Entity – in the UK, PIEs are defined in Section 494A of the Companies Act 2006 and in Regulation 2 of The Statutory Auditors and Third Country Auditors Regulations 2016.

Appendix 2

Inspection results: arising from our review of individual audits

During 2022-23 the most common inspection findings, based on the number of firms where key findings were raised in those areas in the individual public reports, were as follows:

Impairment and valuations

Changes to key assumptions in impairment assessments or valuation models can impact the need to revalue or impair an asset. Auditors must sufficiently evaluate and challenge management's assumptions and cash flow forecasts for these assessments.

We identified examples where the audit teams did not adequately evaluate and challenge management's impairment assessments or valuations, including in relation to:

- Future cash flows forecasts and related growth assumptions in impairment assessments.
- Inputs and calculations for valuation models, including not identifying material modelling errors.
- Independent confirmations, including not obtaining them to support the value of certain investments.

Bank and similar entity audits including ECL provisions

Bank and similar entity audits often include high volumes of transactions, significant management judgement and estimation uncertainty in complex areas. They also require a high level of sector audit expertise. Auditors must tailor the audit procedures to the audited entity's risks, in order to obtain sufficient, appropriate audit evidence, especially in judgemental areas such as Expected Credit Loss (ECL) provisions.

We identified examples of weaknesses in the procedures performed for certain bank and similar entity audits, including inadequate testing of:

- ECL provisions, in particular the testing of significant increases in credit risk (SICR), ECL models and post-model adjustments.
- The payment and settlement process, including not demonstrating that the audit team had an adequate understanding of the related processes.

Revenue

Auditors must obtain sufficient and appropriate audit evidence to assess whether revenue is accurately recognised in the financial statements.

We identified examples where audit teams did not obtain sufficient audit evidence over the revenue recognised, for example:

- Long-term contracts, including inadequate procedures over revenue and margin forecasts.
- IT controls, including insufficient procedures to respond to weaknesses in privilege user access risks.
- Reliance on information prepared by the entity or system-generated information which was not adequately tested.

Other estimates and provisions

Audit teams must adequately assess and challenge management's judgements relating to estimates, including provisions, and perform appropriate procedures to respond to the relevant risks.

We identified examples where the audit teams had not adequately tested the basis of the estimates or had not challenged management sufficiently, including in relation to:

- The completeness of property and restoration provisions and insufficient challenge over the basis for the related estimates.
- Reliance on internal specialists with inadequate follow up on their findings or not sufficiently consulting with them.

Cash and cash equivalents

Auditors must obtain sufficient and appropriate audit evidence to assess whether cash and cash equivalents are accurately recognised in the financial statements. This includes ensuring that the cash flow statement is accurately presented.

We identified examples where the audit teams had not adequately tested the cash and cash equivalents balance or the cash flow statement. This led to the following findings:

- Material errors in the classification of cash flows in the cash flow statement not identified by the audit team.
- Inappropriate netting of cash and overdraft balances on the face of the balance sheet.
- Insufficient confirmation procedures over cash and cash equivalent balances, including short-term deposits, and not performing adequate alternative procedures.

Inspection areas of focus

As part of the 2022-23 inspections of individual audits, we paid particular attention to the audit work in the following areas, due to their continuing or heighted risk:

Cash and cash equivalents, including cash flow statements

The FRC's previous thematic review "Cash flow and liquidity disclosures" highlighted examples of material inconsistencies between items in the cash flow statement and the notes; missing or incorrectly classified cash flows; or inconsistencies between financing cash flows and the reconciliation of changes in liabilities arising from financing activities in the notes.

As a result of this, and high profile cases related to cash, we included the audit of cash and cash flow statements as a new area of focus and reviewed the firms' related policies and procedures. While these audit procedures are well-established, we recommended that more should be done to update them for the FRC thematic review findings, as well as other internal and external inspection findings.

Our 2022-23 inspections scoped in the audit of cash and cash equivalents for all of our inspections and the audit of the cash flow statements for a high proportion of our inspections. We identified examples of good practice on the audits we inspected, including firms performing thorough procedures over bank confirmations.

We also raised findings in our inspections related to this area, including examples of audit teams not obtaining sufficient audit evidence over certain cash and cash equivalent balances and performing insufficient procedures over cash flow statements, as detailed above.

Climate risks

This area continued to be an area of focus in the current year. Our review included a follow up of the climate thematic and firm-wide work performed in prior years, where we had reported that the quality of support, training and resources provided to the audit practice varied considerably across the firms. We requested more to be done by the firms in this area, including in their internal quality monitoring procedures.

Since then, all firms have made progress in developing processes and procedures to support audit teams in identifying and responding to climate change risks, with most firms showing significant enhancements. All firms have, as a minimum, updated their methodology to reflect climate change issues, provided climate-related training and issued specific climate change related communications to staff.

The FRC highlighted to the firms, during 2022, the need to ensure effectiveness of the application of climate change related tools and resources and to monitor implementation continually. Given the speed and complexity with which change can occur in this area, we also requested the firms to ensure that timely updates are made to their guidance and resources for key developments.

Our current year inspections scoped in a review of the audit team's assessment of climate related risks on all audits inspected. We identified examples of good practice, such as an independent assessment of climate-related risks, including using external information to support such analyses. We also noted examples of audit teams challenging the impact of climate change on cash flow forecasts and the appropriateness of climate-related disclosures. Further details are set out in Appendix 4.

We also raised certain findings in this area, including examples of audit teams not sufficiently considering or demonstrating their considerations over the linkage between climate-related disclosures within the other information in the annual report and the impact on the financial statements including in areas such as asset valuation.

Fraud risks

This area continued to be an area of focus, given the continued heightened risk on audits. During the current year, firms have continued to enhance guidance and training in relation to fraud risk assessment, including embedding the requirements of ISA (UK) 240 ahead of the implementation date impacting December 2022 year ends.

We identified examples of good practice on the audits we inspected including: the use of forensic specialists in the risk assessment process to assist with developing a robust audit response; and evidencing a continuance assessment following identification of fraud risk factors (as detailed in Appendix 4).

We also raised findings in this area, including examples of audit teams not sufficiently addressing the risk of management override (for example, not adequately testing journal entries).

The other areas of focus were due to continued heightened risks on audits and were as follows:

- Impairment of assets
- Provisions
- Revenue, and
- Group audits

Details of findings and/or good practice identified in these areas are detailed in Appendices 2 and 4.

2023/24 areas of focus for the FRC's inspections include going concern, fraud risks, climate related risks and the application of the revised standard on risk assessment.

Appendix 3

Inspection results: arising from our review of the Tier 1 firms' quality control procedures

This year, our firm-wide work focused on evaluating the firm's: compliance with the FRC's Revised Ethical Standard (2019); partner and staff matters; acceptance and continuance procedures for audits; and audit methodology relating to settlements and clearing processes for banks and building societies.

The table below provides an outline of the review procedures we performed on four areas of the firms' quality control arrangements and an overview of our findings. The work was primarily based on the policies and procedures the firms had in place at 31 March 2021:

Review procedures performed on the firms' quality control arrangements	Overview of the key findings identified
FRC's Revised Ethical Standard (2019) We evaluated the firms' compliance with the Revised Standard, with focus on: • Prohibited non-audit services. • Timely approvals of non-audit services. • Identification and assessment of threats and safeguards for non-audit services. • Consideration of self-interest threat from fee ratios. • Timely rotation of individuals off audit teams. • Financial independence of relevant individuals.	We identified that all firms need to: • Obtain sufficient assurance that network firms have sought all relevant approvals for non-audit services from the UK firm. Multiple firms need to: • Ensure robust assessments of threats and safeguards are performed before approving a non-audit service. We also identified some firm specific key findings, including the following requiring firms to ensure: • Their processes are sufficiently robust to identify all connected parties, including controlling individuals. • Robust assessments of familiarity threat arising from long association with audited entities are performed. • The implementation of additional personal independence compliance testing. • They increase and enhance central ethics monitoring and approval.

Review procedures performed on the firms' quality control arrangements	Overview of the key findings identified
	• Timely resolution and evidencing of consultations. • Strengthening assessments of proposed accounting advice to ensure they are not performing a non-permissible accounting service. • Appropriate approvals are obtained before work starts on a non-audit service. • Relevant individuals' pension investments are all logged to facilitate prompt conflict identification.
Partner and staff matters, including recruitment, appraisals, remuneration and promotion Our inspection included a review of the firms' policies and procedures in relation to: • The recognition, reward and promotion of partners and staff involved in the delivery of external audits. • Recruitment of audit partners and senior staff. • Accreditation of Responsible Individuals (RIs) to sign audit reports and management of audit partner and senior staff portfolios. We tested the application of these policies for a sample from the 2021 processes.	We identified four firms who needed to improve the process and evidence for staff appraisals. One of these firms needed to strengthen staff objective setting, and two of these firms needed to strengthen the impact of quality on staff remuneration. Three firms needed to strengthen the consistent impact of quality on partner appraisals and remuneration. One firm also needed to improve the evidencing of recruitment decisions. We identified no key findings in relation to the firms' arrangements for accrediting RIs and managing partner and staff portfolios.

Review procedures performed on the firms' quality control arrangements	Overview of the key findings identified
Audit methodology	
We evaluated the quality and extent of the firms' methodology and guidance relating to the audit of the cash and payments process cycle for the audit of banks and similar entities.	We found that three firms needed to improve the quality and extent of guidance in relation to auditing the cash and payments process cycle for the audit of banks and similar entities.
Acceptance and continuance procedures for audits	
Our inspection included a review of the firms' policies and procedures in relation to: • Ensuring the firm only undertakes audits it is competent to do and where it can comply with ethical and regulatory requirements and professional standards. • Undertaking entity and engagement risk assessments for audits. • Issuing the required communication after withdrawal or dismissal from an audit. We reviewed the application of these policies, and the evidence retained, for a sample of audits accepted, continued, or ceased in the year.	We found that one firm needed to improve the timeliness of continuance assessments to ensure that, for each audit, all relevant factors are considered before deciding to undertake the audit of the next financial year.

Appendix 4

What Makes a Good Audit?

In 2021 we published a document called "What Makes a Good Audit?", setting out our experience of what a 'good audit' looks like based on our recent file inspections.

Further good practice continues to be identified across all firms during our inspection of both individual audits and of the firms, quality control procedures.

Figure 1: Key Aspects of the Audit Process

Risk assessment and planning	Execution	Completion and reporting
• Careful risk assessment • Timely planning • Knowledge and understanding • Informed expectations • Auditors' responsibilities relating to fraud • Appropriate resources • Planning analytical review • Planning the group audit • Communicated to those charged with governance	• Fieldwork must execute the agreed audit plan • Appropriate oversight and direction • Proportionate approach to higher risk engagements • Audit documentation tells the story • Professional scepticism and challenge of management • Specialists and experts appropriately involved • Sufficient group oversight • Consultation and oversight	• Assess that sufficient, appropriate audit evidence has been obtained • Communicate matters of interest

Examples of good practice identified in each part of the audit process, in the audits we reviewed in 2022/23, include the following:

Risk assessment and planning

Fraud risk assessment

- Engagement of forensic specialists to develop an enhanced fraud risk assessment and appropriate audit responses.
- A robust audit continuance assessment following identiifcation of fraud risk factors, resulting in the audit team agreeing certain undertakings with the audit entity and performing a comprehensive suite of audit procedures to respond to the increased risks in this area.

Climate risk assessment

- A high quality evaluation of climate change risks and their impact on financial statement disclosures.
- The inclusion of details of the audit team's consideration of climate-related risks in the auditor's report.

Revenue risk assessment and planning

- A comprehensive risk assessment of the entity's revenue streams.
- Good understanding of revenue transaction processes, streams and/or contracts that led to detailed and appropriate audit strategies for revenue.

Execution

Group audit oversight

- Use of a well-evidenced and detailed record of interactions with component audit teams and thorough review of component audit working papers.
- Extensive group audit team oversight of significant risk areas, including reperformance of certain component auditor work.

Challenge of management (including impairment and provisions)

- Robust challenge of management's key assumptions in an impairment assessment, which resulted in updates to the model and further sensitivity analysis being performed.
- Robust challenge by the firm's going concern technical panel of the audit team's assessment, resulting in additional procedures being performed by the audit team.
- Use of a specialist panel to assess and support in challenge to management of provisioning for legal claims, which resulted in enhanced disclosures.

Cash and cash equivalents

- Performance of detailed procedures to assess the quality of bank confirmations.
- A stand-back analysis and critical evaluation of reconciling items for in-scope component bank reconciliations.

Revenue

- Detailed and focused data analytic procedures over revenue, supported by a strong understanding of the entity's revenue transaction process or streams.
- Direct confirmation of contract terms from the entity's customers to provide support over the existence of revenue.

Audits of banks

- High quality audit procedures in areas including general IT controls, the use of independent rebuilds of Expected Credit Loss models and the testing of valuation models for financial instruments.
- Effective design and execution of a data analytics approach to test the core payments process.

Use of specialists

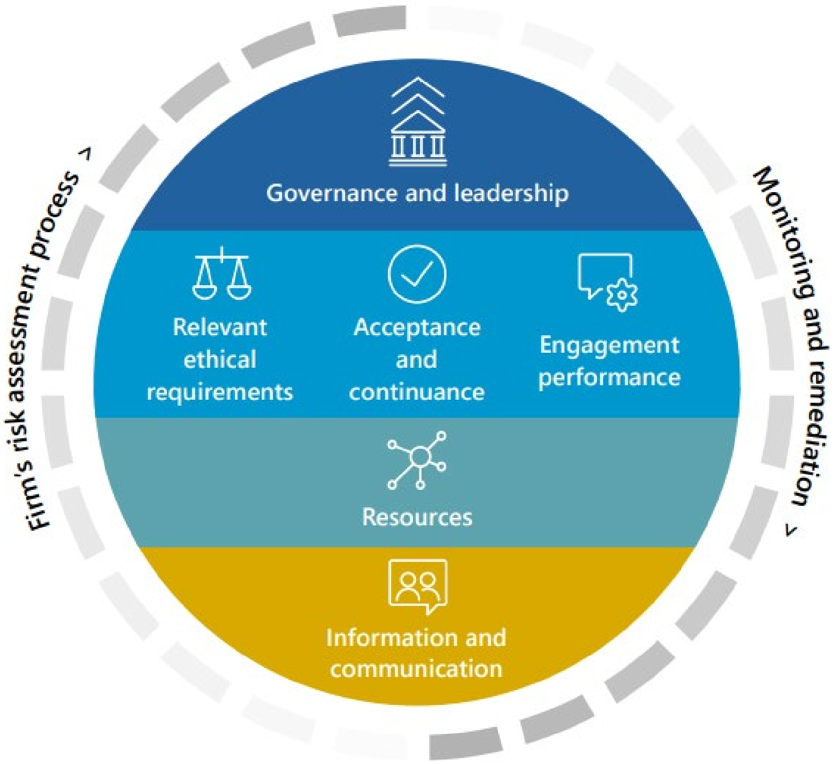
- Involvement of a medical specialist with pharmaceutical industry experience to support robust audit procedures over fair value measures and related financial statement disclosures.

Completion and reporting

Audit Committee reporting

- Inclusion of shared engagement level Audit Quality Indicators in reporting to the Audit Committee, setting out areas of particular importance to delivering a high quality audit.

Figure 2: Key Components of a System of Quality Management



We performed work on four areas of the firms' quality control arrangements in the following components of their systems of quality management, identifying good practice in three of these:

Relevant ethical requirements

- Robust personal financial independence declaration systems, including in-built validation checks for personal independence declarations to flag unusual answers and automated checks of investments recorded against restrictions.
- Comprehensive compliance testing for personal financial independence, including consideration of what audits individuals have recorded time to. Examples of the ethics function challenging audit teams to improve their assessment of threats and safeguards for non-audit services.
- Examples of strong analysis of conflict checks. For example, checks following an acquisition at an audited entity considered not just non-audit services provided to the acquired entity, but also business and employment relationships, in addition to personal investments.
- Following a change in scope, a non-audit service was carefully reconsidered to determine whether the service remained permissible.

Acceptance and continuance

- Mandatory ethics and independence consultations for all PIE and other entity of public interest (OEPI) tenders.
- A stringent holistic review of ongoing audit tenders, tender pipeline and existing audits, based on risk and resourcing, to ensure acceptance and continuance decisions reflect the firm's capacity and strategy.
- For all prospective tenders, requiring justification of why the firm should tender for this work to focus on only accepting audits that align with the firm's quality objectives.
- For all prospective tenders, prompting identification of expected areas of technical challenge and how the firm will address each, with consideration of industry experience.
- For higher risk prospective audits, requiring the central technical team to approve the planned use of specialists and report to the audit governing body on this.

Resources

Partner and staff matters

- Requiring staff to collect feedback for all jobs using questions focused on audit quality and values and requiring managers and above to collect 360 feedback on values and behaviours.
- Producing quality metric reports for all managers and above to show file review results and compliance with archiving deadlines, mandatory training and independence requirements.
- Awarding quality ratings to managers and above, based on file reviews, compliance, internal assessments, feedback from audit quality leaders, and involvement in central quality activities.

- Implementing a range of staff bonus and award schemes to reward positive behaviours and a commitment to audit quality; An annual bonus scheme focused on staff with high quality ratings.
- Rigorous manager and senior manager promotion assessments, such as internal technical tests and presentations, simulated file reviews, interviews with complex technical and risk management scenarios, and external technical assessments.
- Accrediting RIs for specific types of audits only. To widen or change an individual's accreditation, additional quality interviews and assessments are required.
- Considering the appropriateness of RI allocations to PIE audits, and any support needs, based on the size and risk level of RI portfolios, the extent of their experience and any quality metrics.

Appendix 5

Monitoring by the Quality Assurance Department of ICAEW

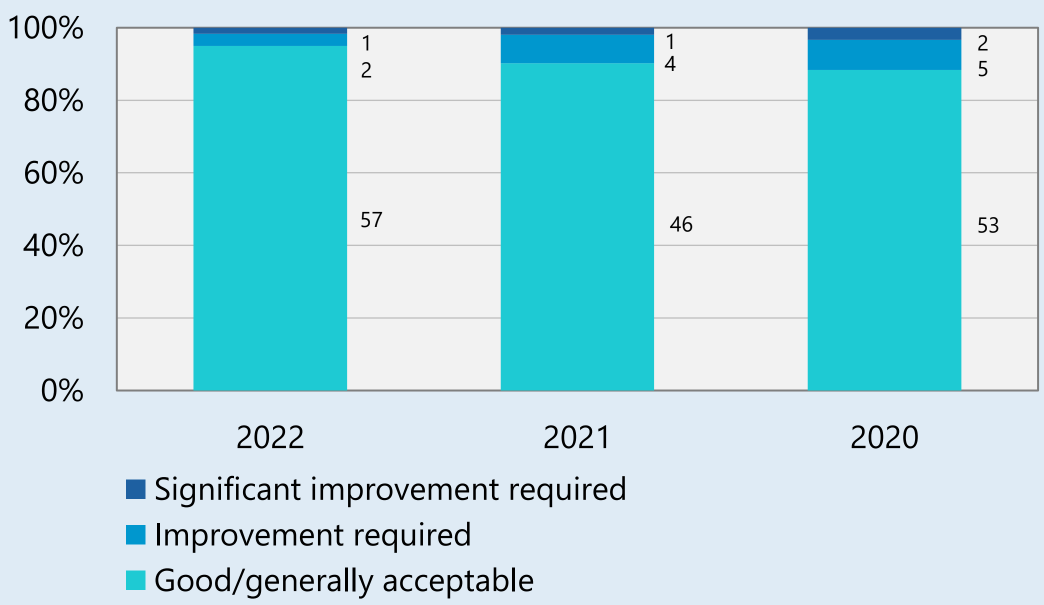
The firms are subject to independent monitoring by ICAEW under delegation from the FRC as the Competent Authority. ICAEW reviews audits outside the FRC's population of retained audits, and accordingly its work covers private companies, smaller AIM listed companies, charities and pension schemes. ICAEW does not undertake work on the firm's firm-wide controls as it places reliance on the work performed by the FRC, except for review of CPD records for a sample of the firm's staff involved in audit work within ICAEW remit.

ICAEW reviews are designed to form an overall view of the quality of the audit. ICAEW assesses these audits as 'good', 'generally acceptable', 'improvement required' or 'significant improvement required'. Files are selected to cover a broad cross-section of entities audited by the firm and the selection is focused towards higher-risk and potentially complex audits within the scope of ICAEW review.

ICAEW has undertaken 2022 monitoring reviews on BDO LLP, Deloitte LLP, Ernst & Young LLP, Grant Thornton UK LLP, KPMG LLP and PricewaterhouseCoopers LLP and the reports summarising the audit file review findings and any follow up action proposed by each firm will be considered by ICAEW's Audit Registration Committee in July 2023.

Results

Combined results of ICAEW's reviews at the largest audit firms* for the last three years are set out below.



*All three years include inspection results of Deloitte LLP, Ernst & Young LLP, KPMG LLP and PricewaterhouseCoopers LLP. BDO LLP and Grant Thornton UK LLP are included in the 2022 and 2020 results. Mazars LLP is included in the 2021 results only.

Given the sample size and differences in the firms within scope of the reviews, changes from one year to the next in the proportion of audits falling within each category cannot be relied upon to provide a complete picture of performance or overall change in audit quality.

Summary

Overall the quality of audit work reviewed across all six firms was of a good standard, with 95% of reviews graded either good or generally acceptable.

Good practice seen in 2022 included:

- Demonstrable professional scepticism and challenge of management in engagement team approaches to accrued income, going concern and impairment reviews.
- Effective use of internal specialists with clear linkage to audit work done and conclusions reached.
- Clear documentation of the review of key contracts, drawing out key terms and setting out the challenge of judgements made by management.
- Detailed records of a group audit team's interaction with component auditors at key stages of the audit.
- Thorough and robust risk assessment procedures.
- The approach to risk assessment and consideration of fraud, including evaluation of IT controls work and testing of manual journal entries.

Of the 60 files reviewed, two required improvement and one required significant improvement. All of these more significant points related to areas unique to the individual audits, including:

- A specific error in transactions relating to refinancing within the group with a risk that the parent company balance sheet was materially misstated. The issue did not alter the group balance sheet position.
- Weaknesses in audit evidence, including aspects of revenue and creditors linked to the impact of Covid-19 on the audited entity.
- More evidence needed to test aspects of contract accounting.

The audits also exhibited some good practice and, in one case, the audit team had to deal with numerous other challenges in the conduct of the audit leading to a modified audit opinion.

ICAEW

95%

An increasing number of ICAEW reviews were assessed as either good or generally acceptable.

Appendix 6

Forward looking supervision by the FRC

Our supervisory approach is forward-looking – identifying and prioritising what firms must do to improve audit quality and enhance resilience. In addition to our audit inspections and firm-wide quality control work, we undertake various initiatives to hold firms to account and identify and share good audit practice to drive further improvements. Examples of our proposed actions for 2023/24 are outlined in this section.

Single Quality Plan

The SQP was introduced, as we required, by the Tier 1 firms during the year and is maintained by each firm as a mechanism to prioritise, and monitor the effectiveness of, the implementation of actions to improve audit quality. Firms are at various stages of implementation and regular engagement has been undertaken during the year to ensure that these overarching plans capture key priorities for the firm and have clear actions to address and progress the priority areas.

- Oversight and monitoring of the SQP: Firms must ensure that the SQP has an appropriate level of monitoring and independent oversight. We consider regular engagement with and monitoring by senior leadership and Audit Non-Executives (ANEs)/Independent Non-Executives (INEs) to be a key control. Where firms have not already instigated this, they must engage with these individuals, seeking regular feedback.
- Continual evolution of priorities: Recognising that the SQP is a working document that responds to changes in risk and priorities, firms must regularly consider the continued appropriateness of existing risks and responses. Two tier 1 firms have responded positively to new information which changed the firm's risk level and as a result increased the priority of a topic. In one case, the firm further demonstrated how another matter was no longer a key priority for the firm.
- Effectiveness measures: As firms develop their SQP's they must consider both quantitative and qualitative effectiveness measures to determine whether the action taken has addressed the identified risk or whether additional actions are required. These measures must be clearly linked to the objective and priority with evidence to support the conclusion.

Where firms are not achieving their SQP objectives, we will hold them to account against their plan and consider where further actions are necessary.

International Standard on Quality Management

In the current inspection cycle, 2022/23, prior to the implementation of ISQM (UK) 1, we held discussions with the firms to understand their plans and progress for implementation, focusing on how the firms have:

- Established oversight of and accountability for their system of quality management.
- Identified quality objectives, risks and responses and assessed the significance of their quality risks and the design and implementation of their responses.
- Identified the service providers and network resources that they rely upon in their system of quality management and how they would assess the reliability of these on an ongoing basis.
- Planned to undertake monitoring activities over their system of quality management on an ongoing basis.

Since the implementation of ISQM (UK) 1 we have begun our statutory monitoring under this standard.

In the first inspection cycle under ISQM (UK) 1, (2023/24), we are focusing on the firms' identification of objectives, risk assessment processes and the completeness of the risks identified. In addition, we are reviewing certain components of the system of quality management, including governance and leadership, acceptance and continuance, network resources and service providers. In these areas we are looking at the design and implementation of responses. We are also reviewing the firms' plans for ongoing monitoring and remediation of the system of quality management and the annual evaluation process.

On an ongoing basis, our inspection will be undertaken on a risk focused and cyclical basis, supported by targeted thematic work where we will perform in-depth reviews of particular aspects of firms' systems of quality management. Our thematic reviews in the 2023/24 inspection cycle will cover the following areas:

- Audit sampling methodology, within the engagement performance and intellectual resources components.
- Hot reviews, within the engagement performance component.
- Identification and assessment of network resources and service providers, within the resources component.
- Root Cause Analysis, within the monitoring and remediation component.

We will also annually review the ethics component as this continues to be a priority area for the FRC, where our work will again focus on firms' compliance with the Revised Ethical Standard 2019 through compliance testing, review of breaches reported and regular interaction with the firm's ethics functions.

Other annual areas of review will include elements of monitoring and remediation, including root cause analysis and audit quality plans, and leadership and governance, including tone from the top.

Culture and Conduct

Audit firms need the right culture to drive the right behaviours, which in turn are necessary for high quality audits. We undertake work to assess and monitor various aspects of culture at the firms, with a specific focus on the behaviours and mindset that correlate to high quality audit.

We also expect firms to have an ethical culture, and we monitor ethical conduct matters, including non-financial misconduct. Reported instances of integrity issues or misconduct matters have a significant impact on trust and confidence in the profession. Ethical conduct must therefore be an intrinsic part of all firms' cultural programmes and the profession must strive to maintain a culture of integrity in which the highest standards of ethical values and professional behaviour are upheld.

In November 2022 we completed a thematic review of the environment for auditor scepticism and challenge at each of the Tier 1 firms, including a review of their training, culture and operating procedures. We published a report setting out examples of good practice, which was then followed by a tailored private report for each firm with specific recommendations.

We identified good practice in relation to training and communication from leadership and were pleased to note that we are starting to see signs of a shift from a 'client centric' culture to one with a greater focus on the public interest purpose of audit. We noted areas for improvement in relation to ensuring consistency of behaviours, alignment of reward and recognition and the firms' speak up culture. The biggest barrier to professional scepticism and challenge continues to be a perceived lack of time and resources and we are challenging firms on how they are addressing this through their operating model and project management.

Firms are at various stages of their culture journey. Those that have more advanced cultural programmes, where desired audit specific behaviours are promoted through their wider policies and procedures (in particular training and coaching, performance management and reward and recognition), typically have better or improving audit quality.

During 2023/24 we will perform an ongoing assessment of audit firms' cultures with a specific focus on the firms' own culture assessment and encouraging a speak up culture. We will also be undertaking a survey across all Tier 1 firms to provide further evidence and cross-firm benchmarking of elements of audit firm culture that promote high quality audit.

Audit Firm Governance Code

Independent Non-Executives (INEs), Audit Non-Executives (ANEs) and the FRC share a common objective which is to act in the public interest.

The revised Audit Firm Governance Code refers to INEs and ANEs promoting the public interest. However, it can be difficult for INEs and ANEs to know what's expected of them when faced with difficult real world situations. Although public interest is a key consideration for INEs and ANE it is rarely their only consideration. A range of dilemmas was discussed at an FRC roundtable event for INEs and ANEs from Tier 1 firms. This included firms' decisions as to whether or not to tender for an audit. The discussion extended to whether public interest differs if the entity is or isn't an existing client, either for audit or other services. Local Audit was discussed, including whether the public interest threshold differs for the public sector versus the private sector. The FRC want to know that INEs and ANEs have asked the right questions. Ultimately INEs and ANEs should not be the firm's conscience, but they must ensure that the firm has its own conscience.

The new AFGC comes into effect for firms during our next inspection cycle and we will be assessing the Tier 1 firms' implementation in 2024/25.

Operational Separation

Operational Separation aims to ensure that the audit practices of the four largest firms are focused, above all, on the delivery of high quality audits in the public interest, and are financially resilient. All four firms are continuing their transition to operating the audit practice separately from the rest of the firm and have taken a number of steps to implement the principles of Operational Separation.[7]

All four firms have an Audit Board which is chaired by and has (or is recruiting in order to have) a majority of Audit Non-Executives (ANEs). Their role is to oversee firms' strategy. They also work with firms' management on promoting a differentiated audit culture.

In addition, all firms have defined policies on what types of engagement can and cannot be led from within their separate audit practice, and have created separate financial information for the audit practice.

Operational Separation does not apply to the remaining Tier 1 firms, but we have been pleased to see each taking steps to consider the principles, including forming Audit Boards and appointing ANEs.

During 2023/24 we will continue to assess the progress of the four firms' transition plans, to ensure their compliance with operational separation by the end of the transition period in 2024. We will discuss the matters arising directly with the firms during the transition period.

[7] The transition period runs until 2024 (varying by firm depending on their individual financial year-ends).

Audit Quality Indicators

Following consultation[8], the FRC has developed a set of firm-level Audit Quality Indicators (AQIs) to be measured on a consistent and comparable basis for public reporting. This will broaden the range of information regarding audit quality available to audit committees and other stakeholders.

These AQIs can be used by Audit Committee Chairs to enhance conversations on Audit Quality. It is envisaged that the reporting framework for AQIs will facilitate a comparison of a range of metrics across the firms with significant PIE portfolios. Firms within the scope of the Audit Firm Governance Code will provide their data privately to the FRC for a pilot year (2023-24). This will allow some sense checking and, where necessary, refinements. We plan to publish the firms' latest data in summer 2025 and annually thereafter.

PIE Auditor Registration

The FRC is now responsible for the registration of all firms and Responsible Individuals (RIs) which carry out statutory audit work on PIEs, in addition to the ongoing requirement for firms and RIs to register with their Recognised Supervisory Body. The FRC's registration remit covers firms and relevant RIs which audit one or more "public interest entities" which includes: UK-incorporated entities listed on the London Stock Exchange (or other UK-regulated market); a UK registered bank, building society or other credit institution (but not credit unions or friendly societies); or are a UK insurance entity which is required to comply with the Solvency II regulations.

All firms and RIs carrying out statutory audit work on PIEs were required to register with the FRC by 5 December 2022 under a set of transitional regulations. Thereafter, any firm that plans to take on a PIE audit, or remain auditor to an entity that is to become a PIE (for example, if it obtains a listing on the London Stock Exchange), together with its relevant RIs, must register with the FRC before undertaking any PIE audit work.

Where appropriate, we hold firms and/or RIs to account through conditions, undertakings and suspension or involuntary removal of registration. The measures utilised by PIE auditor registration are not always published.

[8] https://www.frc.org.uk/consultation-list/2022/aqis-consultation

On the Horizon – ARGA and the FRC's transformation programme

The FRC continues its strategy for taking the organisation through a period of significant change pending the creation of the ARGA. This includes the publication of the Position Paper in July 2022 setting out the next steps to reform the UK's audit and corporate governance framework. That paper itself followed the May 2022 Government Response to the consultation on strengthening the UK's Corporate Governance, Corporate Reporting and Audit systems, and the creation of ARGA. Both documents emphasised the multiple channels through which reform can be achieved, including primary and secondary legislation, regulation, guidance and market-led actions.

Building on our focus on the areas of the Government Response that fall within the FRC's remit, we will continue to concentrate on using our existing mandate as the UK body responsible for developing and maintaining audit, assurance and ethics standards in the public interest. Our Audit & Assurance Sandbox initiative will provide us with richer insights into how standards can support improved audit and assurance quality. We have recently published our Audit Committee Standard, and we will use our engagement and outreach with FTSE 350 audit committees to better understand how they will use this standard to improve conversations with their auditors, tendering processes and the resultant disclosures in their annual report and accounts. Whilst the standard will remain voluntary for these audit committees prior to legislation, we will take the opportunity to refine our proposed monitoring to ensure that we achieve the best regulatory outcomes for the least amount of burden on audit committees and auditors.

Elsewhere within our integrated transformation programme, a number of projects led by our Supervision division are well-progressed. PIE auditor registration has successfully transitioned into a 'business as usual' state. Our AQR team are progressing several workstreams designed to provide a more efficient and effective AQR process, with greater engagement with audit committees being a key part of their work. We have also agreed a new strategy to deepen and strengthen our supervision of professional bodies, alongside a project looking at how auditor education and training incorporates such as professional integrity and fraud awareness – two areas we commonly see associated with our root cause analyses of poor audits. While we await a clearer legislative timetable, we will press forward with these projects, which are well-aligned to our current strategic objectives and will make a positive difference to those we regulate and the wider system of audit and assurance.

Appendix 7

Tier allocations 2023/24

We focus our risk-based supervision on those firms that have the largest share of the UK Public Interest Entity (PIE) audit and Major Local Audit (MLA) markets and thus where weaknesses in the firm would have the greatest impact on overall audit quality. Our approach is proportionate and is supported by organising firms into appropriate tiers.

We consider the number and nature of the firm's audits, and other risk factors that may apply, for example the firm's growth plans or specific risks to audit quality, when assessing which tier is appropriate. The tiering decision impacts the level of supervisory activity each firm can expect, including the frequency of our audit inspection programme and assessment of the audit practice's system of quality management. In March, we updated Our Approach to Audit Supervision with further details of our proportionate and tiered approach. We have recently undertaken a re-evaluation of all firms that fall within our supervision and have reallocated several firms including Grant Thornton UK LLP who, effective May 2023, are now included within Tier 2.

Tier 1 (6 firms)

- BDO LLP
- Deloitte LLP
- Ernst & Young LLP
- KPMG LLP
- Mazars LLP
- PricewaterhouseCoopers LLP

Tier 2 (6 firms)

- Crowe U.K. LLP
- Grant Thornton UK LLP
- Johnston Carmichael LLP
- MacIntyre Hudson LLP
- PKF Littlejohn LLP
- RSM UK Audit LLP

Tier 3 (21 firms)

- Anstey Bond LLP
- Beever and Struthers
- Begbies
- Bennett Brooks & Co Ltd
- Bright Grahame Murray
- BSG Valentine (UK) LLP
- CBW Audit Limited
- Deloitte (NI) Limited
- Gerald Edelman LLP
- Grant Thornton (NI) LLP
- Haysmacintyre LLP
- Hazlewoods LLP
- Johnsons Financial Management Ltd
- Kreston Reeves LLP
- LB Group Ltd
- Moore Kingston Smith LLP
- Pointon Young Limited
- Price Bailey LLP
- Royce Peeling Green Ltd
- RPG Crouch Chapman LLP
- Shipleys LLP

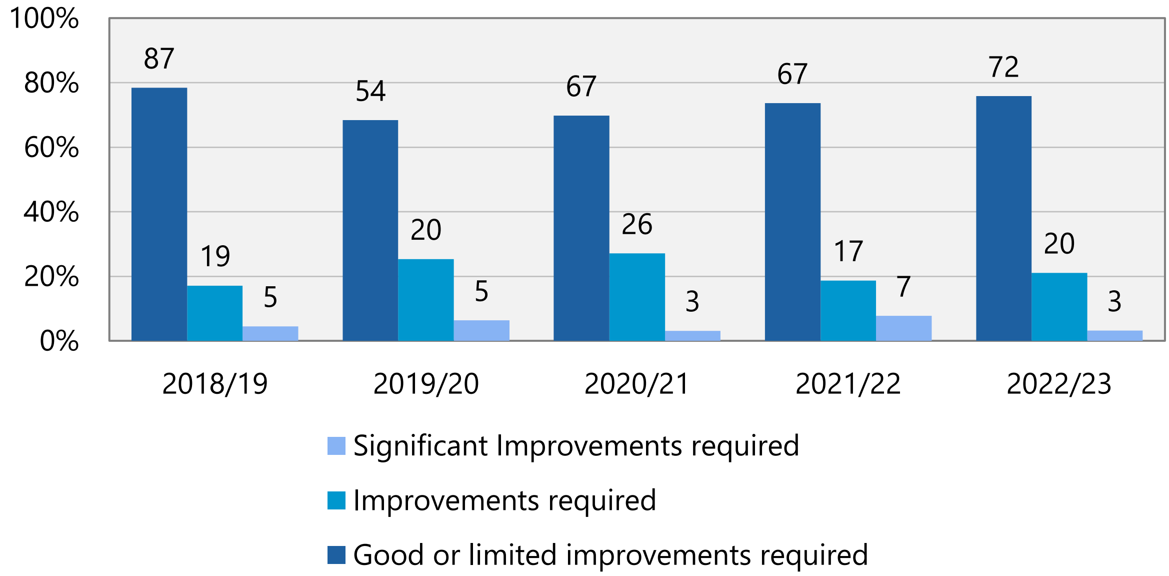
Note: Total number of firms on the PIE Auditor Register, as at 30 June 2023, is 41, being the 33 listed above plus: 3 Ireland based audit firms (Deloitte Ireland LLP, Ernst & Young and KPMG), 2 Channel Island based audit firms (KPMG Channel Islands Limited and KPMG Audit LLC) and 3 individuals registered to undertake audits of PIEs in the name of the National Audit Office.

Grant Thornton UK LLP being included in Tier 2 in 2023/24 means that in 2024 we plan to publish individual public reports on six firms rather than seven. This will change the comparative data on audit quality inspection results.

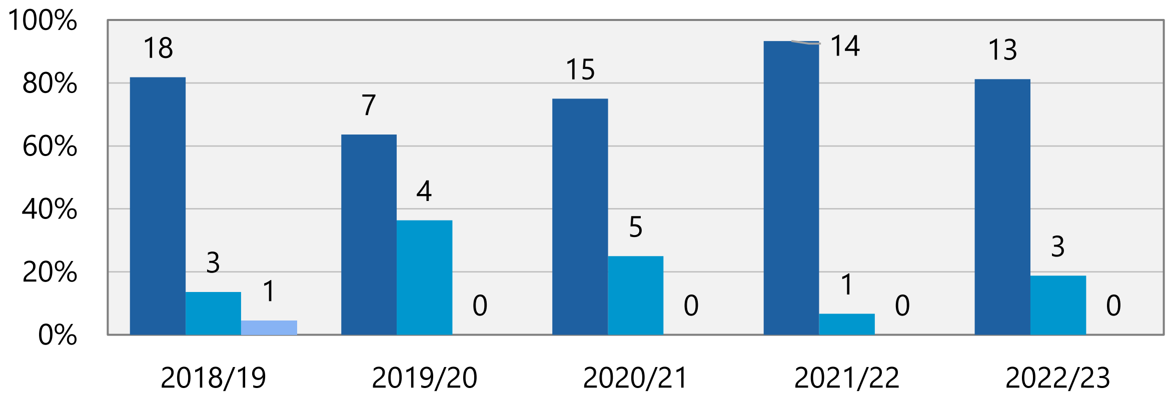
The following table sets out the commentary provided on page 5 along with the details for comparative basis going forward excluding Grant Thornton UK LLP. We have also updated the graphs included on pages 10 and 11 to show the trend for the last four years without Grant Thornton UK LLP.

Overview commentary: Tier 1 audit firms including Grant Thornton UK LLP	Overview commentary: Tier 1 audit firms excluding Grant Thornton UK LLP
Of the audits inspected, 77% were categorised as good or limited improvements required (2021/22: 75%).	Of the audits inspected, 76% were categorised as good or limited improvements required (2021/22: 74%).
Over the last four years we have seen a 10% increase in this key measure of audit quality.	Over the last four years we have seen an 8% increase in this key measure of audit quality.
We reviewed 100 individual audits.	We reviewed 95 audits.
Six of the seven firms have improved or maintained their audit quality results, with at least the same percentage of inspections requiring no more than limited improvements.	Five of the six firms have improved or maintained their audit quality results, with at least the same percentage of inspections requiring no more than limited improvements.
It is particularly encouraging that five of the firms had no audits requiring significant improvements, with the number of audits requiring significant improvement having reduced to 3% (2021/22: 7%).	It is particularly encouraging that four of the firms had no audits requiring significant improvements, with the number of audits requiring significant improvement having reduced to 3% (2021/22: 8%).
The FTSE 100 audits are often the most complex entities and, of the 16 audits inspected, none were identified as requiring significant improvements.	No impact – Grant Thornton UK LLP do not currently audit any of the FTSE 100.
Of the 27 FTSE 250 audits we reviewed this year, we assessed 22 (82%) as achieving this standard.	Of the 26 FTSE 250 audits we reviewed this year, we assessed 21 (81%) as achieving this standard.

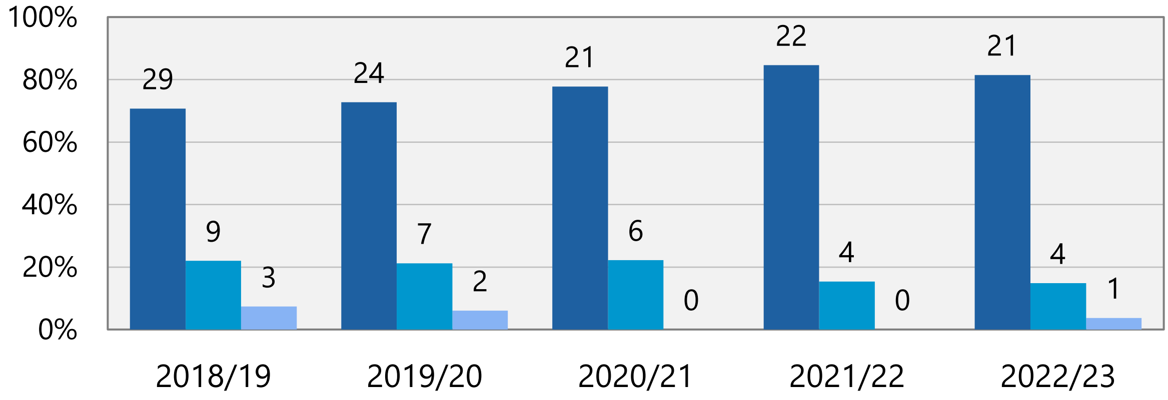
All inspections: Tier 1 (6 firms)



FTSE 100



FTSE 250



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