



Financial Reporting Council

# MAZARS LLP

## AUDIT QUALITY INSPECTION

JULY 2020

---

# 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.

transparency



We have responsibility for the public oversight of statutory auditors.

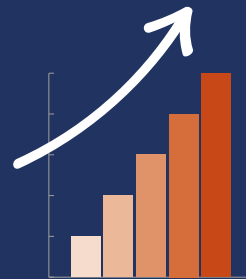
The FRC works with European, US and global regulators to promote high quality audit and corporate reporting.



# AQR

We monitor the quality of UK Public Interest Entity audits.

+155	0.20%	+2.27%	-11.48%	POS	-3.2320
+320	0.21%	+2.83%	-15.93%	NEG	-3.9993
+485	0.14%	+2.42%	-17.67%	POS	-4.2421
+650	0.27%	+2.19%	-18.32%	NEG	-4.2083
+815	0.27%	+2.28%	-14.73%	NEG	-3.5708
+980	0.20%	+2.76%	-20.12%	NEG	-2.8339



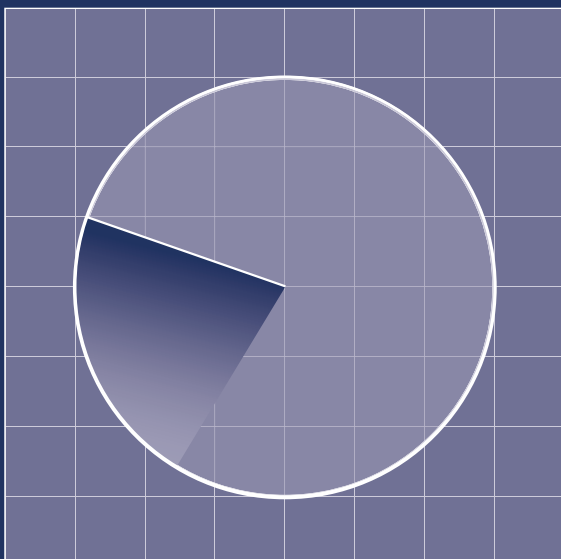
We promote continuous improvement in audit quality.

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



# The Firm

Mazars LLP has 46 audits within the scope of AQR inspection, none of which are in the FTSE 350.



# 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 5 Mazars 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.



# Financial Reporting Council

## Mazars LLP

### Audit Quality Inspection

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.

## Contents

<b>1</b>	<b>Overview</b>	<b>5</b>
<b>2</b>	<b>Review of individual audits</b>	<b>12</b>
<b>3</b>	<b>Review of firm-wide procedures</b>	<b>14</b>
	<b>Appendix 1:</b> Firm's internal quality monitoring and ICAEW results	<b>20</b>

This report sets out the principal findings arising from the 2019/20 inspection of Mazars LLP ("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 April 2019 to March 2020 ("the time of our inspection"). We inspect Mazars, and report publicly on our findings, annually.

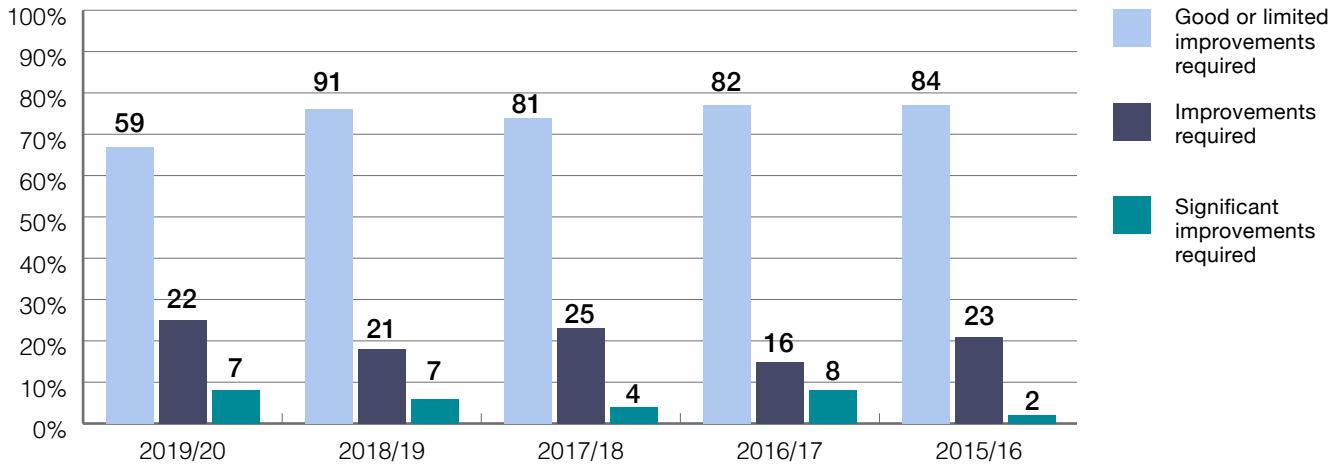
Our report focuses on the key areas requiring action by the firm to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the firm's audit work. Our findings cover matters arising from our reviews of both individual audits and the firm's policies and 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 misstatements, fraud and financial frailties, putting 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.

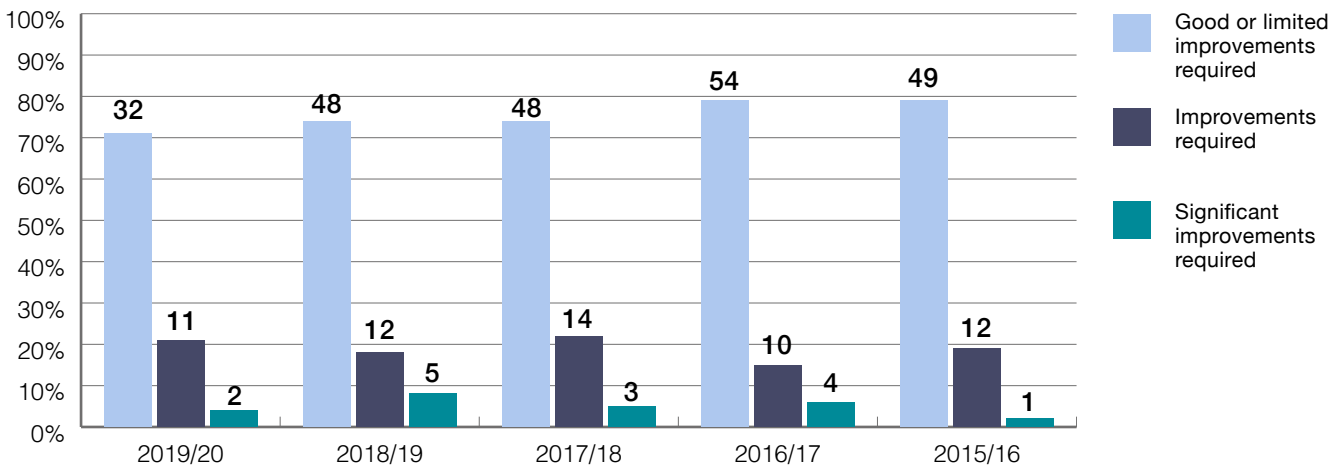
## Our assessment of the quality of audits reviewed

### 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 although we reviewed the same number of audits at Mazars as last year. 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 2019<sup>1</sup> 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.

<sup>1</sup> [https://www.frc.org.uk/news/december-2019-\(1\)/letter-to-audit-firms-on-high-quality-audits](https://www.frc.org.uk/news/december-2019-(1)/letter-to-audit-firms-on-high-quality-audits)

- 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.

## Mazars overall assessment

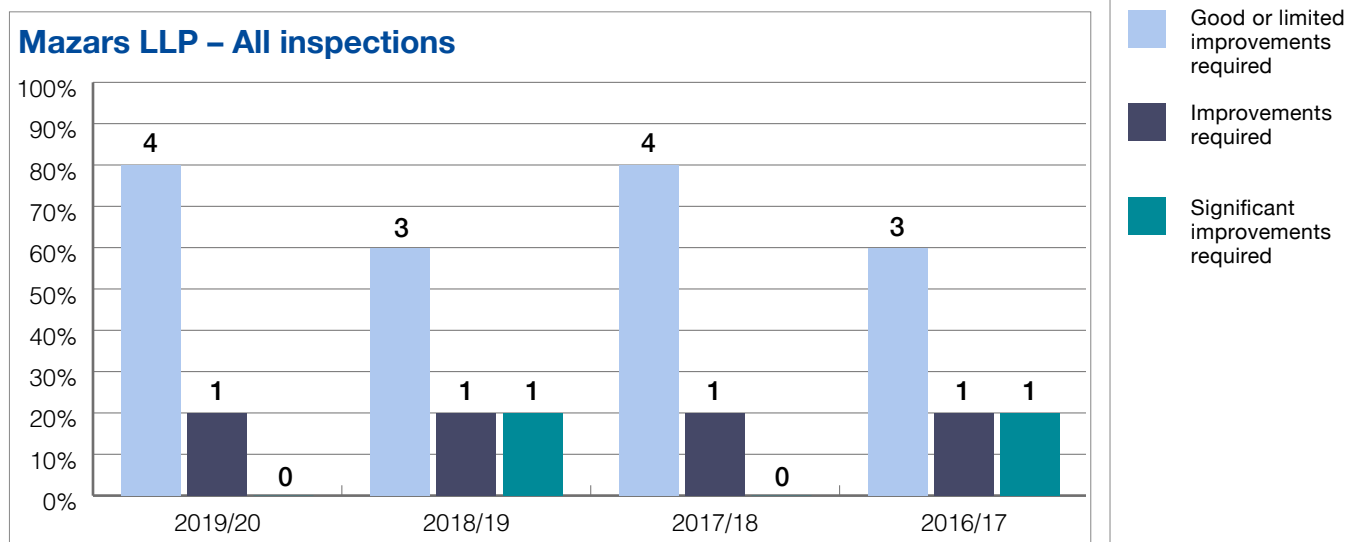
We reviewed five individual audits this year and assessed four (80%) of them as requiring no more than limited improvements. The firm has made progress in relation to the key findings highlighted in last year's report with no recurring issues identified.

We also identified good practice in a number of areas of the audits we reviewed (including testing the valuation of insurance technical provisions) and in the firm-wide procedures (including the firm's audit quality initiatives' focus on culture and audit team behaviours).

We identified findings in all of the firm-wide areas reviewed in the current year which the firm needs to address. Some of the findings on partner and staff matters are similar to those raised in our 2016/17 inspection. The firm has, however, made progress in addressing prior year findings in relation to independence and ethics and has improved the consultation and monitoring processes for non-audit services.

The firm is experiencing significant growth with changes in its audit portfolio and its appointment as auditor on larger and more complex audits. This calls for more rigorous, effective management and quality control systems. The firm should continue to strengthen audit quality initiatives and focus, as applicable, on resourcing, formalisation of sector-specific guidance and work programmes to supplement the firm's overall audit methodology and addressing audit quality in relation to both individual audit findings and firm-wide issues raised. In view of the above, we intend to inspect a higher number of audits as part of the 2020/21 inspection cycle.

## Our assessment of the quality of audits reviewed



## Reviews of individual audits

Our key findings related principally to the need to:

- Strengthen audit procedures in relation to testing inventory existence and valuation.
- Improve the consideration of judgements in key areas, including valuation of expected credit loss for financial instruments.



---

## Good practice observations

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

- Testing of the valuation of insurance technical provisions.
- Delaying sign-off of the auditor's report due to a number of factors including potentially material unreconciled differences in key account balances.

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 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 FY18 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 to ensure that effective actions are taken to address recurring inspection findings.

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

#### *Partner and staff matters*

- Improve monitoring of the staff appraisal process and consideration of audit quality in relation to relevant metrics in staff appraisals.
- Enhance the significance of quality in determining partners' performance ratings and remuneration.

#### *A&C procedures*

- Enhance controls on continuance decisions to prevent teams undertaking audit work prior to this being approved.
- Strengthen the continuance approval process, in particular the evidence to record and explain the conclusions reached.

#### *Audit quality initiatives*

- Formalise the monitoring of the implementation of and on-going governance over the firm's Audit Quality Plan.
- Formalise the resourcing requirements plan for the audit division.

- Assess the scope and role of hot reviews to enhance audit quality and to meet the requirements of the firm's growing audit practice.

#### **RCA process**

- Review and formalise the firm's RCA plan and ensure it is aligned to the firm's Audit Quality Plan.

### Good practice observations

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

- Encouraging the right culture and audit team behaviours as part of the firm's audit quality initiatives.

Further details of our findings in these firm-wide areas are given in section 3, together with the firm's actions to address them, as well as details of the good practices identified.

### **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 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:

- The firm's RCA process is in the early stages of development and is less mature than the other firms. The firm has begun to address the findings in section 3 and has commenced an independent RCA process for external inspection findings and good practice. The firm has not yet commenced RCA reviews for internal inspection findings and good practice.
- The level of coverage of RCA reviews for external inspection findings is lower than some other firms and does not currently include firm-wide findings.

- Due to the stage of maturity of the RCA process, the firm is still at the process of identifying themes arising from inspection findings and good practice.
- The actions reported to the firm's leadership are less detailed compared to some of the other firms and are more focused at the inspection, rather than the firm-wide, level. Other firms have gone further in determining where actions are needed that affect the whole audit practice.

We will continue to assess the firm's RCA process and encourage all firms to develop their RCA techniques further.

### **Firm's overall response and actions:**

In these challenging times, both in terms of the impact of Covid-19 and the uncertainty associated with debates around Market Reform, we continue to support the efforts of the Financial Reporting Council, in demanding improvements in the quality of the audit work performed on Public Interest Entities.

We know that confidence in the audit profession can only be restored through a focus on delivering high quality audits. The firm has made significant investments in terms of our people and underlying audit infrastructure during the past year to provide our teams with the appropriate tools and resources to deliver high quality audits. We are pleased that the FRC has recognised our efforts in terms of focusing on audit quality and that this is reflected by the improvement in our file gradings in the year. We are disappointed that one of our audits was considered to require more than limited improvements.

We consider that a key element of improving audit quality is an appropriate culture that embeds quality in underlying behaviours to re-enforce concepts such as professional scepticism and management challenge. These principles underpin the firm's ongoing Audit Quality Plan, the delivery of which is a key priority for the firm in the immediate future. We look forward to continued constructive discussions and engagement with the FRC to ensure that our processes and methodology continue to evolve to promote audit quality.

As outlined in the responses prepared for each of the findings, we have performed a root cause analysis to establish the underlying reasons for these findings to enable us to establish focused and detailed remediation plans to prevent similar issues arising in the future. The lessons learnt from this exercise are in the process of being communicated to the wider team.

As in the prior year we have welcomed the challenge provided by our Independent Non-Executives in respect of our proposed Audit Quality Plan and other associated quality initiatives.

We will monitor closely the promptness and effectiveness of the firm's actions. Should these not address our concerns adequately, we will consider appropriate action.

---

## 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.

### **Strengthen audit procedures in relation to testing inventory existence and valuation**

The existence and valuation of inventories may be judgemental and require technical expertise. Audit teams should assess and evidence their understanding of management's processes and controls over the valuation and existence of inventories.

On one audit we identified the following weaknesses in the testing of inventories:

- The audit team did not assess or evidence its understanding of management's processes and controls over the valuation and existence of all types of inventories at all applicable locations.
- The audit team did not corroborate the existence of certain inventories to third-party evidence; in addition, the team did not assess the competence of external stock take providers used by management in order to rely on the evidence obtained by them.

#### **Firm's actions:**

As part of our mandatory annual technical training programme for 2020 we will provide a reminder of the firm's methodology in relation to inventory. This will include a focus on:

- The importance of understanding management's processes over the valuation and existence of all types of material inventories at all applicable locations;
- Our requirements to corroborate the existence of inventories to third-party evidence; and
- Where external stock take providers are used by management, that we should assess their competence in order to rely on the evidence obtained by them.

We are currently assessing our current methodology in relation to inventory in the context of Covid-19, in particular procedures that would constitute effective roll back procedures and the use of technology to perform inventory counts remotely, while ensuring the completeness and accuracy of stock count data.

---

## Improve the consideration of judgements in key areas including valuation of expected credit loss for financial instruments

The valuation of financial instruments and expected credit loss in financial services entities involves significant management judgement and estimation uncertainty. Auditors should undertake appropriate procedures to assess management's key judgements.

The matters raised below should be considered when planning all audits of financial services entities. The firm needs to strengthen its methodology in this area to achieve consistent, high quality audit work, in particular to ensure a consistent and robust approach to the audit of larger, more complex entities.

- In one audit, the group audit team did not adequately evidence how it considered and concluded on counterparty risk assessment associated with derivative instruments tested by a component auditor.
- For one financial entity audit, we identified weaknesses in the testing of certain key assumptions in the valuation of expected credit loss on loans and advances.

### Firm's actions:

In our mandatory annual technical programme for 2020 we will include a session to remind audit teams of the requirements to agree the nature, scope and timing of work with the component auditor.

The firm continues to develop its methodology in place in relation to IFRS 9, which reflects our growth in the banking sector and the change in our client mix as we continue to win complex clients. As part of this process the firm is working with our global firm to ensure that our methodology is constantly under review and aligned to the risk profile of our client base. Our methodology includes a focus on the testing of key assumptions. We will remind audit teams that appropriate application of this methodology should be applied across all aspects of the banking client portfolio. Adherence to this methodology will be assessed as part of our quality monitoring programme.

### Good practice

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

- Similar to last year, we identified examples of good practice in the audit of the valuation of insurance technical provisions. In two audits, the scope and evidencing of the procedures performed to test the valuation of technical provisions, including the involvement of actuarial specialists, was of a high standard.
- In another review, the engagement quality control reviewer and the firm's hot review process requested the partner to delay the sign-off of the auditor's report due to several outstanding matters including, but not limited to, potentially material unreconciled differences in key account balances.

---

## 3 Review of firm-wide procedures

We reviewed the 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 relating to the FY18 performance year.
- 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:

- Improve monitoring of the staff appraisal process and consideration of audit quality in relation to relevant metrics in staff appraisals: We observed significant weaknesses in staff compliance with the firm’s requirements around objective setting and appraisal completion. As of April 2019, fewer than 40% of staff had appropriately completed their FY18 appraisal in the firm’s performance management system, and only half had set objectives for FY19. Across the sample of individuals reviewed, there were several instances where there was no or only limited evidence of the appraisal performed or of how audit quality had been considered. We also identified concerns around the lack of a formal process to ensure that all relevant quality metrics (including the results of internal or external inspections) were considered and appropriately reflected in senior staff appraisals and objective setting.

- Enhance the significance of quality in determining partners' performance ratings and remuneration: The firm's processes, partner performance ratings and variable remuneration may be positively or negatively adjusted as a result of audit quality. However, in practice, such adjustments were typically limited in their size and impact. We observed that, in the majority of cases in FY18, adverse audit quality findings did not result in an overall deduction to remuneration. In addition, we noted that there was insufficient evidence in the firm's FY19 pay review process to clearly demonstrate how audit quality considerations had affected biennial decisions taken over movements in partner fixed pay. We also identified concerns around the tailoring of annual quality objectives to respond to previously identified adverse quality findings.

### **Firm's response and actions:**

We fully acknowledge the importance of these processes and were disappointed with the FY18 findings. We have already made significant improvements with regards to the FY19 and continuing improvement is ongoing in respect of the FY20 year.

Changes to monitoring and metrics have been implemented for both teams and partners and developments include:

- Ensuring that performance reviews and objective setting are more closely monitored in terms of both the prompt and complete documentation, but also in terms of the quality of the metrics and processes that impact remuneration decisions. For FY19 almost 100% of performance reviews and FY20 objectives were included within the firm's HR system.
- The requirement for specific quality objectives to be included for those senior audit team members or partners with adverse quality control reviews in the prior period or with additional audit quality responsibilities.
- While the results of quality control reviews were included in remuneration considerations for senior audit team members and all partners in FY19, the determination and collation of a broader range of quality metrics will be included as part of FY20 performance reviews.
- With effect from FY20, we have instigated changes to ensure that the impact of audit quality is more clearly embedded and documented within the process, with improved tracking of the impact on final remuneration for all partners.
- These changes for partners include a reduction in the grading range such that there is a greater direct impact on remuneration for adjustments related to quality. In addition to this, the partner assessment documentation has been amended to facilitate a much clearer and increased focus on quality for partners in all service lines across the firm.

The firm further enhanced the consideration of the impact of quality on the final remuneration of all partners in respect of FY19 and this will be further developed going forward.

---

## 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 firm-wide 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 findings:

- Enhance controls on continuance decisions to prevent teams undertaking audit work prior to this being approved: The firm's internal review noted that some audit continuance assessments were not completed on time and consequently staff were performing work on engagements before the continuance decision had been approved, increasing the risk to the firm. The process should be strengthened and monitored to ensure that an audit cannot commence until the continuance approval process has been completed.
- Strengthen the continuance approval process, in particular the evidence to record and explain the conclusions reached: The firm's continuance form focuses on a choice of set responses, often without supporting narrative (for example, to explain why previous risk factors are no longer relevant, why it is appropriate to continue acting for the audited entity and how it aligns with the firm's overall strategy). It does not give sufficient prominence to the assessment of the potential impact on the firm's brand and reputation risk or the resources required by the firm to undertake the engagement.

### Firm's response and actions:

Our internal monitoring had identified that improvements were required in our continuance procedures and we agree with the FRC's comments made in respect of this area.

Over the last year we have strengthened the controls around audit acceptance decisions and further enhancements will be made in 2020 with regards to both acceptance and continuance. These developments will include improvements in the documentation of conclusions reached such that there is clarity of decision for each of the many factors to be considered.



---

## Audit quality initiatives

### Background

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

The plan is a framework setting the cultural basis upon which audit quality will be delivered.

Key areas of focus include:

- Restructuring of the audit division.
- Audit Quality Team resourcing.
- Training on project management.
- Enhancing the Acceptance & Continuance process.

The firm's Audit Board approved the plan in October 2019. As the plan did not start until the end of 2019, it did not have any impact on the audits we reviewed in this inspection cycle.

### Key findings

The firm should accelerate its plans to strengthen audit quality through the plan. Key areas of focus include, but are not limited to, addressing AQR's and the firm's own quality monitoring, file review and firm-wide findings; and responding to the audit division's growth requirements, including where applicable resourcing and formalisation of sector-specific audit methodology. The plan should also be clearly linked to the firm's RCA.

Our key findings are set out below:

- Formalise monitoring of the implementation of and on-going governance over the plan: The firm should formalise monitoring of the implementation of the plan by the firm's leadership, establishing a clear monitoring process. This should include prioritisation of key initiatives, implementation of specific projects and consideration of milestones.
- Formalise the resourcing requirements plan for the audit division: The plan currently considers only the composition of the audit quality team. The plan should also formally incorporate and consider the overall resourcing requirements for the audit division. There should also be a clear link to the firm's acceptance and continuance and risk management procedures. Prior to accepting an audit engagement there should be careful consideration of the resourcing requirements and expertise necessary.

- Assess the scope and role of hot reviews to enhance audit quality and to meet the requirements of the firm's growing audit division: The firm should finalise its review of the scope and role of hot reviews and establish a process aligned to the firm's growing audit portfolio.

### *Good practice*

We identified the following areas of good practice:

- **Culture and audit team behaviours:** The aim of the programme is to engage the whole team in a quality improvement process focusing on key behaviours to drive quality. Key behaviours include professional scepticism and challenge of management.

### **Firm's response and actions:**

In relation to the Audit Quality Plan, the firm's Audit Board is responsible for the monitoring of the implementation and on-going governance of the plan. A review of the status of the Audit Quality Plan is now considered on a monthly basis by the Audit Board. This is considered in relation to the key priorities that have been established by the Audit Board, together with associated milestones to monitor delivery and impact. A key element of the Audit Quality Plan is to re-enforce the firm's culture to ensure that we are consistently delivering high quality audit and demonstrating appropriate professional scepticism and management challenge as examples.

Resourcing of the audit division is considered by the firm's Audit Operations Team, which comprises the Head of Audit, Business Unit Leaders and the Partner responsible for Audit Quality and Support. This process includes the development of staffing needs of the growth areas of the audit practice to assess the future staffing needs of the audit practice.

Going forward the scope and role of the hot reviews will be monitored and approved by the Audit Board. This will include consideration of the adequacy of the composition of the Audit Quality Team in order to meet the continuing growth in the audit service line.

## **The Firm's RCA process**

### *Background*

The RCA process should be designed to identify the causes of inspection findings, in order 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 a number of years as part of its internal quality monitoring process. This year, we have reviewed the firm's process for undertaking its RCA, including resources and timing.

---

### *Key findings*

We identified the following key findings related to the firm's RCA process:

- Review and formalise the firm's RCA plan and ensure it is aligned to the firm's Audit Quality Plan: The firm until recently performed RCA, solely as part of its internal quality monitoring process. The firm has commenced reviewing its current RCA arrangements and has developed an independent RCA for external inspection findings with plans to expand to internal findings as well. The firm should ensure that its RCA arrangements are aligned with the firm's growth, recurring firm-wide and file review findings and its Audit Quality Plan.

#### **Firm's response and actions:**

The firm's Audit Board has approved a RCA plan for 2020, which is in the process of being implemented. This revised approach to RCA is now independent from the firm's internal quality monitoring plan and involves a comprehensive assessment of the drivers behind both poor and good audit quality on individual files. This new RCA process will factor in the findings and conclusions from the quality monitoring process and challenge any underlying themes or risk factors identified to arrive at an independent assessment.

The Audit Board is responsible for monitoring the delivery of this RCA plan, and will assesses progress on a monthly basis together with ensuring that it is aligned with the overall Audit Quality Plan.

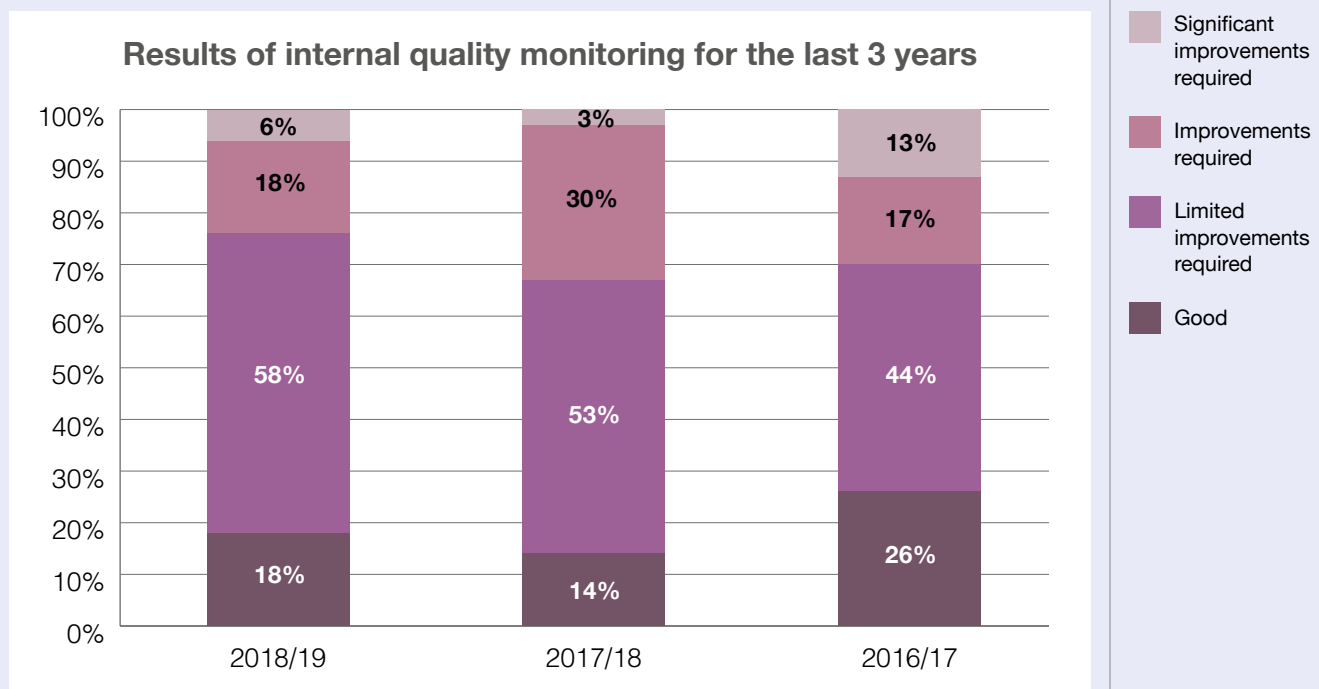
## Appendix 1: Firm’s internal quality monitoring and ICAEW results

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 Internal Quality Monitoring (“iQM”) program, which comprised internal inspections of 34 individual audits with periods ending between 30 June 2017 and 31 December 2018, are set out below along with the results for the previous two years.



The firm’s iQM program uses the same grading categories as AQR. Decisions on grading are aligned as closely as possible to those that would result from the AQR process.

## Firm's approach to internal quality monitoring

The firm's internal inspection program considers the full population of audits performed. The program is designed to cover each Responsible Individual ("RI") at least once every two years (prior to the 2017/18 cycle: every three years). Audit files are selected for review based on a number of criteria, including risk and public interest. Reviews are supervised by the Director of Audit Standards and are conducted by appropriately trained and experienced reviewers, with specialist technical support where required. The Director of Audit Standards reviews all findings to ensure that the firm's processes and grading criteria are applied appropriately and consistently, and proposed grades are reviewed by the Head of Quality and Support before signing out final findings to the RI and audit team.

The firm currently undertakes root cause analysis ("RCA") as part of the file review for all key findings, where the RI is asked to reflect on the findings to identify the likely cause. Action plans are also prepared for each inspection to address key findings at an engagement level in the subsequent year's audit, which are followed up as part of the iQM programme. Where significant deficiencies are noted, the Head of Quality and Support will meet with the RI to discuss the findings.

In the 2019/20 review cycle, independent RCA is being undertaken for those files where improvements and significant improvements required are noted. This is being done outside the iQM review process but within 60 days of a review being completed by an independent team of RCA investigators.

### Firm's response and actions:

The firm operates a robust internal QM review programme, aiming to at least match the challenge shown by the AQR in its file reviews. We are proud of an uncompromising approach to quality monitoring as a key part in continually striving to improve audit quality, and we seek to raise the bar in these reviews year on year. We consider our findings are broadly in line with those of the AQR.

We are pleased to see an overall increase in the proportion of those files requiring no or limited improvements only. We are disappointed by any file that required anything other than limited improvements and our aim is to ensure we have no files within that category.

As noted above, the firm has moved to reviewing each RI every two years in the 2017/18 cycle and this is reflected in the number of file reviews undertaken which rose from 23 in 2016/17 to 37 and 34 in the following two cycles.

The QM review process requires that individual file findings are discussed with the relevant audit team who are asked to document their consideration of the cause for any finding, and reflect that in their planned actions to address.

The internal quality monitoring findings are reported 3 times a year to the Audit Board. Included in this reporting are the Audit Quality Team's responses to the key themes and findings which may include the delivery of additional training or supplementary guidance. The frequency of reporting means that responses can be put in place quickly to address findings at a firm wide level.

Set out below are the key findings from the 2018/19 completed IQM review programme along with actions taken to address them. All QM findings are communicated in a QM briefing session to audit staff as part of the mandatory annual audit masterclass training.

FINDING	OUR RESPONSE
Insufficient auditor challenge in relation to PPE valuations.	Sector and firm wide training sessions in this area which included various case studies and discussion.
Insufficient audit evidence in journal testing to address management override of controls – this included lack of evidence to support the completeness of the journal population tested and failure to agree journals to source documentation.	A mandatory journal testing template has been released which includes clear instructions on work required. Help sheets covering this topic have also been released.
Insufficient challenge of management in relation to going concern and evidence provided by management.	The 2019 mandatory annual audit masterclass training to all audit staff included a case study around these aspects of auditing going concern.
Poor quality documentation and review – this related to files where the number of documentation related findings indicated a requirement to improve the overall standard of documentation and review although each finding in isolation was not significant.	This was a key message in the 2019 mandatory annual audit masterclass training to all audit staff.

## 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

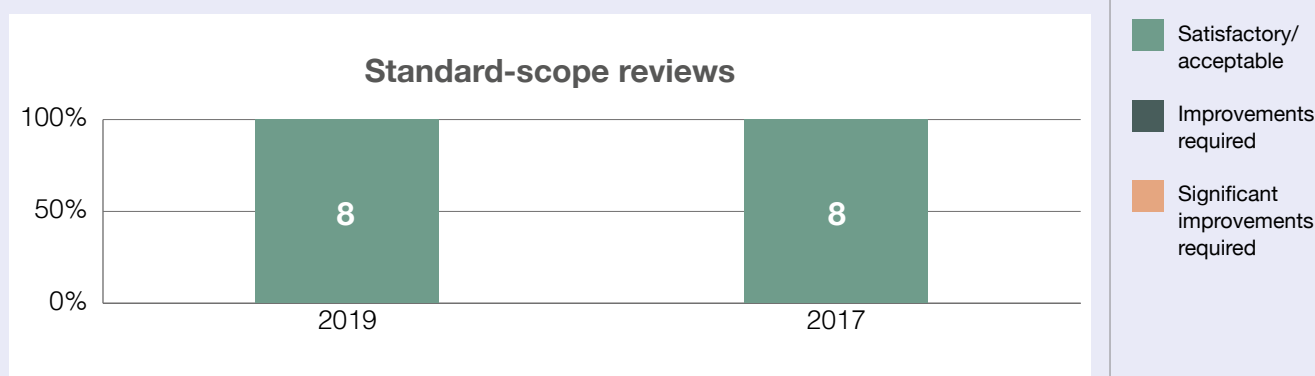
Reviews of audits are either standard-scope or focused. Standard-scope reviews are designed to form an overall view of the quality of the audit. ICAEW assesses the audits it reviews as either 'satisfactory/acceptable', 'improvement required' or 'significant improvement required'. Where appropriate, ICAEW 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](http://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, ICAEW concluded that the firm's audit work was of a good standard and all files were satisfactory or acceptable. ICAEW did not carry out any focused reviews. Findings were fairly isolated, and related mainly to weaknesses in documentation. ICAEW identified and shared a number of examples of good practice.

Results of ICAEW's standard-scope reviews for its 2019 and 2017 visits are set out below. ICAEW's 2018 visit was a shorter catch-up visit which did not include reviews of audit files.



Given the sample size, 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 a firm's performance or overall change in audit quality.

---

## Response from the firm

We are pleased that the ICAEW has noted that the audit work reviewed was of a good standard. The ICAEW principle findings from each review have been communicated to the relevant audit team with the instruction to ensure the specific findings are addressed in the current year and our internal quality monitoring programme will follow these up to ensure the points are addressed.



---

This report has been prepared for general information only. The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

© The Financial Reporting Council Limited 2020  
The Financial Reporting Council Limited is a company limited by guarantee.  
Registered in England number 2486368.  
Registered Office: 8th Floor, 125 London Wall, London EC2Y 5AS

**FINANCIAL REPORTING COUNCIL  
8TH FLOOR  
125 LONDON WALL  
LONDON EC2Y 5AS**

**+44 (0)20 7492 2300**

**[www.frc.org.uk](http://www.frc.org.uk)**